LIBRARY
SUPREME COURT, U. S.

Supreme Court, U. S.
FILED
JUL 25 1975
MICHAEL RODAK, JR., CLERK

IN THE

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1974

No. 75-133

GORDON D. CLARK, *Petitioner,*

v.

OTEY JOHNSON, ET AL., *Respondents.*

Petition for a Writ of Certiorari to the United States Court of Appeals for the Tenth Circuit

Henry W. Simon
John W. Hughes
SIMON & SIMON
800 Baker Building
110 West Seventh Street
Fort Worth, Texas 76102

J. D. DeBois
O. L. Peck, Jr.
DEBOIS, PECK & SHERRILL
P. O. Box 1427
Duncan, Oklahoma 73533
Attorneys for Petitioner

Fort Worth Brief Printing Co., 610 S. Jennings Street Phone 332-4070

SUBJECT INDEX TO PETITION

Page

INDEX TO APPENDIX iv

LIST OF AUTHORITIES v

INTRODUCTION 1

OPINIONS BELOW 1

JURISDICTION 2

QUESTIONS PRESENTED

Question 1. Whether the Court of Appeals, in its Opinion of May 29, 1975 (Appendix A, infra, pp. A-1-A-22), has so far departed from the accepted and usual course of judicial proceedings by completely disregarding the "clearly erroneous rule" (Rule 52[a], F.R.C.P.) so as to call for an exercise of this Court's power of supervision because the Court below failed to consider the evidence supporting the District Court's findings of fact (Appendix C, infra, pp. A-25-A-37) and only considered some of the evidence to make de novo findings of fact in the opinion and judgment below (Appendix A, infra, pp. A-1 - A-22) and (Appendix D, infra, pp. A-38 - A-39. 2

Reason: The accepted and usual application in judicial proceedings of the clearly erroneous rule (Rule 52[a] of the Rules of Civil Procedure for the United States District Courts) is so far departed from in the decision below of the Court of Appeals that same constitutes plain and simple error.

Question 2. Whether an unknowing and faithful trustee in bankruptcy is to be charged and held strictly liable for defalcations by an employee of the trust by application of the doctrine set forth in *Mosser v. Darrow*, 341 U. S. 267 (1951) which involved a trustee knowingly authorizing employees to engage in self-dealing rather than the application of the principles of negligence. 2

SUBJECT INDEX TO PETITION (Continued)

Page

Reason: The treatment and application of *Mosser v. Darrow*, 341 U. S. 267, (1951) by the Court of Appeals in its decision below, is an enlargement upon this Court's holding in *Mosser* to an extent of effectuating an overruling thereof and creates a rule of strict liability for trustees in bankruptcy.

Question 3. Whether the Court of Appeals has in its Opinion of May 29, 1975 (Appendix A, infra, pp. A-1 - A-22) decided an important question of substantive law in conflict with applicable decisions of the Tenth Circuit of Appeals that prohibit a party who has assumed a certain position in a legal proceeding and succeeds in maintaining that position to thereafter maintain a contrary position in another legal proceeding simply because his interests have changed; and to the prejudice of a party who acquiesced in the position formerly taken by him. 3

Reason: The decision by the Court below is in conflict with applicable decisions of the Court of Appeals on the matter of the application of the doctrine often interchangeably referred to as collateral estoppel, judicial estoppel, res judicata, and preclusion against taking inconsistent position.

Question 4. Whether a trustee in bankruptcy in a Chapter XII, real property arrangement, empowered to operate the business and manage the property of the bankrupt debtor is to be subject to surcharge for reasonable and necessary expenses incurred in such administration solely for failing to request the Court to hold annual hearings for approval of such expenditures when: (a) Title 11, U.S.C., Sec. 845, provides that the trustee "... during such operation or management shall file reports thereof with the court at such intervals as the court may designate"; and (b) the court designates and directs the trustee, all in accordance with the plan of arrangement, to only file a profit and loss statement each month with the court and to file with the court an

SUBJECT INDEX TO PETITION (Continued)

Page

annual report showing the operation of the trust and to furnish such annual report to each creditor; and (c) the Petitioner strictly complied with such bankruptcy statute, direction of the court, and plan of arrangement, and, further, mailed copies of the annual reports to the residuary beneficiaries as well as the creditors each year; and (d) the Petitioner received no further designation from the court or any objection from any of the creditors or residuary beneficiaries as to the form, correctness, sufficiency, reasonableness, or necessity of such expenditures contained in said reports during the entire tenure of the Petitioner as trustee until the Petitioner sought termination of the arrangement in accordance with its own terms; and (e) neither the court nor any interested party ever suggested, requested, or directed that there be annual hearings for approval of the statements and reports filed by Petitioner. 3

Reason: The Petitioner should not be subject to surcharge for any of the reasonable expenses incurred in the operation and management of the trust because he complied with and performed in accordance with the bankruptcy court's direction and applicable law; principles of equity apply herein and should have protected Petitioner.

STATUTES INVOLVED IN THIS CASE 4

CONCLUSION 33

PRAYER 34

SIGNATURES 34

CERTIFICATE OF SERVICE 35

APPENDIX ..... A-1 - A-55

SUBJECT INDEX TO APPENDICES

Page

APPENDIX A — Opinion of the United States Court of Appeals for the Tenth Circuit entered May 29, 1975 ..... A-1

APPENDIX B — Order and Opinion of the United States Court of Appeals for the Tenth Circuit denying rehearing and rehearing en banc A-23

APPENDIX C — Oral opinion of the United States District Court for the Eastern District of Oklahoma rendered from the bench on April 19, 1974 ..... A-25

APPENDIX D — Judgment of the Court of the United States Court of Appeals for the Tenth Circuit entered May 29, 1975 ..... A-38

APPENDIX E — Plan of Arrangement dated May 11, 1960 ..... A-40

APPENDIX F — Order of the Court approving Plan of Arrangement dated May 11, 1960 ..... A-50

APPENDIX G — Excerpts from instructions to the jury in the State Court case, Gordon D. Clark, Trustee, et al v. Exchange National Bank and Trust Company, Ardmore, Oklahoma, In the District Court in and for Carter County, Oklahoma, Cause No. C-70-220 ..... A-52

APPENDIX H — Oklahoma Trust Act, 60 O.S.A. Sec. 175.24 ..... A-55

LIST OF AUTHORITIES

Cases: Page

Anco Mfg. & Supply Co., Inc. v. Swank, 524 P.2d 7 (Oklahoma 1974) 28

Bahler v. Fletcher, 474 P.2d 329 (Ore. 1970) 28
Bernhard v. Bank of American Nat. Trust & Savings Ass'n, 122 P.2d 892 (California 1942) 28
Blau v. Lehmann, 368 U.S. 403 (1962) 20

Campbell v. Barsky, 265 F.2d 463 (5th Cir. 1959) 18
Chandler v. McKerral, 68 F.2d 343 (7th Cir. 1934) 27
Cook, In re, 28 F.2d 521 (D. Ct. D. Mass. 1928) 31, 32

Davis v. Wakelee, 156 U.S. 680 (1895) 27
Donovan & Schuenke v. Sampsell, 226 F.2d 804 (9th Cir. 1955) 20

Eads Hide & Wool Company v. Merrill, 252 F.2d 80 (10th Cir. 1958) 27

First National Bank of Muskogee, Oklahoma, Trustee of the Roy M. Johnson Creditors Trust v. Exchange National Bank and Trust Company, Ardmore, Oklahome, 517 P.2d 805 (Oklahoma 1973) 12

Hankins v. District Court of Jackson County, 424 P.2d 26 (Oklahoma 1967) 28
Hughes v. Ward Oil Corp., 124 F.2d 393 (5th Cir. 1942) 27

Krause v. Krause, 26 N.E. 2d. (N.Y. Ct. App. 1940) 28

Laws v. Fisher, 513 P.2d 876 (Oklahoma 1973) 28
Lewis v. Aubrey, 404 P.2d 1005 (Okla. 1965) 28
Lewis Mach. Co. v. Aztec Lines, 172 F.2d 746 (7th Cir. 1949) 18
Linkletter v. Walker, 381 U.S. 618 (1965) 20

Magnolia Petroleum Company v. Ouart, 192 P.2d 698 (Okla. 1948) 28
Michaelson v. Simula, 250 N.W. 264 (Michigan 1933) 28
Mosser v. Darrow, 341 U.S. 267 (1951) 2, 19, 20, 21, 22, 23
Murphy v. Northern Colorado Grain Company, 488 P.2d 103 (Colo. 1971) 28

LIST OF AUTHORITIES (Continued)

Page

Perkins v. Benquet Consol. Mining Co., 132 P.2d 70 (DCA, First District, Div. 1, Calif. 1942) 28
Peterson v. Strayer, et al, 237 N.W. 667 (Nebraska 1931) 28
Philadelphia, Wilmington, and Baltimore R.R. v. Howard, 54 U.S. 307 (13 How. 305) (1851) 27

Queenan v. Mayes, 90 F.2d 525 (10th Cir. 1937) 27

SEC v. Capital Gains Research Bureau, 375 U.S. 180 (1963) 20
Scarano v. Central R. Co. of New Jersey, 203 F.2d 510 (3rd Cir. 1953) 27

TMT Trailer Ferry, Inc., In re, 334 F.2d 118 (5th Cir. 1964) 21

United States v. Katy Drug Co., 150 F.2d 681 (8th Cir. 1945) 27
United States v. Mason, 412 U.S. 391 (1973) 21

White v. Murtha, 343 F.2d 831 (5th Cir. 1965) 30, 31
Wilkey v. Southwestern Greyhound Lines, Inc., 322 P.2d 1058 (Oklahoma 1958) 28

Zenith Radio Corp. v. Hazeltine Research, Inc., et al, 395 U.S. 100 (1969) 17

Statutes and Rules:

11 U.S.C. §11 6
11 U.S.C. §47(c) (1952) 2
11 U.S.C. §845 ..... 3, 4, 5, 29, 30
28 U.S.C. §1254(1) (1970) 2
Rule 5[illegible] F.R.Civ.P. 2, 5, 15, 17, 18
Oklahoma Trust Stat., 60 O.S.A. §175.1 7

Miscellaneous:

31 ALR3rd 1044 28
31 Corpus Juris Secundum, Estoppel, §115-117 27
57 Harv. L. Rev. 98 27
59 Harv. L. Rev. 1132 ..... 27, 28
Restatement of the Law of Judgments, pp. 389-390 28

IN THE

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1974

No. .....

GORDON D. CLARK, *Petitioner*,

v.

OTEY JOHNSON, ET AL., *Respondents*.

Petition for a Writ of Certiorari to the United States Court of Appeals for the Tenth Circuit

---

The Petitioner, Gordon D. Clark, respectfully prays that a writ of certiorari issue to review the judgment and opinion of the United States Court of Appeals for the Tenth Circuit entered in this proceeding on May 29, 1975.

OPINIONS BELOW

The opinion of the Court below (Appendix A, infra, pp. A-1 - A-22) has not yet been reported.

Order and opinion denying rehearing and rehearing en banc in the Court below appears in Appendix B, infra, pp. A-23 - A-24.

The oral opinion of the District Court appears in Appendix C, infra, pp. A-25 - A-37.

JURISDICTION

The judgment of the Court below was entered on May 29, 1975 (Appendix D, infra, pp. A-38 - A-39). A timely petition for rehearing and rehearing en banc was denied on June 19, 1975 (Appendix B, infra, pp. A-23 - A-24).

This petition for a writ of certiorari is filed within ninety (90) days of that date.

This Court's jurisdiction is invoked under 28 U.S.C., Sec. 1254(1) (1970), and 11 U.S.C.A., Sec. 47(c) (1952).

QUESTIONS PRESENTED

1. Whether the Court of Appeals, in its Opinion of May 29, 1975 (Appendix A, infra, pp. A-1 - A-22), has so far departed from the accepted and usual course of judicial proceedings by completely disregarding the "clearly erroneous rule" (Rule 52(a), F.R.C.P.) so as to call for an exercise of this Court's power of supervision because the Court below failed to consider the evidence supporting the District Court's findings of fact (Appendix C, infra, pp. A-25 - A-37) and only considered some of the evidence to make de novo findings of fact in the opinion and judgment below (Appendix A, infra, pp. A-1 - A-22, and Appendix D, infra, pp. A-38 - A-39).

2. Whether an unknowing and faithful trustee in bankruptcy is to be charged and held strictly liable for defalcations by an employee of the trust by application of the doctrine set forth in *Mosser v. Darrow*,

341 U.S. 267 (1951), which involved a trustee knowingly authorizing employees to engage in self-dealing rather than the application of the principles of negligence.

3. Whether the Court of Appeals has in its Opinion of May 29, 1975 (Appendix A, infra, pp. A-1 - A-22) decided an important question of substantive law in conflict with applicable decisions of the Tenth Circuit Court of Appeals that prohibits a party who has assumed a certain position in a legal proceeding and succeeds in maintaining that position to thereafter maintain a contrary position in another legal proceeding simply because his interests have changed and all to the prejudice of a party who acquiesced in the position formerly taken by him.

4. Whether a trustee in bankruptcy in a real property arrangement, empowered to operate the business and manage the property of the bankrupt debtor, is to be subject to surcharge for reasonable and necessary expenses incurred in such administration solely for failing to request the Court to hold annual hearings for approval of such expenditures when:

(a) Title 11, U.S.C., Sec. 845, provides that the trustee ". . . during such operation or management shall file reports thereof with the court at such intervals as the court may designate."; and

(b) The court designates and directs the trustee, all in accordance with the plan of arrangement, to only file a profit and loss statement each month with the court and to file with the court an annual report

showing the operation of the trust and to furnish such annual report to each creditor; and

(c) The Petitioner strictly complied with such bankruptcy statute, designation of the court, and plan of arrangement and, further, mailed copies of the annual reports to the residuary beneficiaries as well as the creditors each year; and

(d) The Petitioner received no further designation from the court or any objection from any of the creditors or residuary beneficiaries as to the form, correctness, sufficiency, reasonableness, or necessity of such expenditures contained in said reports during the entire tenure of the Petitioner as trustee until the Petitioner sought termination of the arrangement in accordance with its own terms; and

(e) Neither the court nor any interested party ever suggested, requested, or directed that there be annual hearings for approval of the statements and reports filed by Petitioner.

STATUTES INVOLVED IN THIS CASE

"§845. Operation of business and management of property; reports

The trustee or the debtor in possession shall have the power, upon authorization by and subject to the control of the court, to operate the business and manage the property of the debtor during such period, limited or indefinite, as the court may from time to time fix, and during such operation or management shall file reports there-

of with the court at such intervals as the court may designate."

Bankruptcy Act, 11 U.S.C.A. 845

FEDERAL RULES OF CIVIL PROCEDURE

"Rule 52. Findings by the Court.

(a) Effect. In all actions tried upon the facts without a jury or with an advisory jury, the court shall find the facts specially and state separately its conclusions of law thereon, and judgment shall be entered pursuant to Rule 58; and in granting or refusing interlocutory injunctions the court shall similarly set forth the findings of fact and conclusions of law which constitute the grounds of its action. Requests for findings are not necessary for purposes of review. Findings of fact shall not be set aside unless clearly erroneous, and due regard shall be given to the opportunity of the trial court to judge of the credibility of the witnesses. The findings of a master, to the extent that the court adopts them, shall be considered as the findings of the court. If an opinion or memorandum of decision is filed, it will be sufficient if the findings of fact and conclusions of law appear therein. Findings of fact and conclusions of law are unnecessary on decisions of motions under Rules 12 or 56 or any other motion except as provided in Rule 41(b)."

STATEMENT OF THE CASE

This case evolves from proceedings under a Chapter XII Arrangement of the Bankruptcy Act. The District Court for the Eastern District of Oklahoma had original jurisdiction of this case under 11 U.S.C.A. 11. The debtor, Roy M. Johnson, had his principal place of business, resided, and had his domicile in that district for most of his life, which was more than the preceding six (6) months prior to filing his petition in the District Court in this matter. He had never theretofore been adjudicated a bankrupt nor filed for bankruptcy.

The debtor was engaged in the oil and gas production business in Ardmore, Oklahoma. In the fall of 1957, he found himself unable to meet his financial obligations as they became due. He employed Gordon D. Clark, a geologist (Petitioner herein), under a contract of employment to assume control and operation of his properties. Attempts were made to reach an agreement with creditors for a composition. The contract of employment was in writing and later was approved by the Bankruptcy Court. After the Petitioner had unsuccessfully attempted to work out a composition with the creditors from the fall of 1957 until August of 1958, a petition was filed for an arrangement with creditors under Chapter XII of the Bankruptcy Act on August 5, 1958. On the same date, the court made and entered an order appointing Petitioner to be trustee and stayed action of creditors pending determination of the approval or denial of the plan of arrangement. The plan of arrangement was finally

approved by the Court on May 11, 1960 (Appendix E, infra, pp. A-40 - A-49).

The plan of arrangement provided with reference to accounting by Petitioner as follows:

> "4.01 The trustee shall, on or before the 10th day of each month, file with the Clerk of the United States District Court of the Eastern District of the State of Oklahoma, a profit and loss statement covering the preceding calendar month.
>
> "4.02 The trustee shall, on or before the 1st day of February of each year, file with the Clerk of the United States District Court at Muskogee, Oklahoma, a report showing the operation of said trust for the preceding calendar year. At the time of the filing thereof, said trustee shall furnish a copy thereof to each creditor of all classes."

The approved plan of arrangement with reference to the powers of the Petitioner had the further provision:

> "3.05 In addition to the powers herein specifically enumerated, but subject to the specific provisions contained herein, the trustee shall have all the powers provided by the Oklahoma Trust Act, 60 O.S.A. 175.1, et seq., and any amendments thereto." (Appendix E, infra, pp. A-40 - A-49)

Petitioner filed all monthly statements and annual reports required by the plan of arrangement and the order of the court during his tenure as trustee and mailed to each and every unpaid creditor and residuary beneficiary such annual statements. There was never any objection made by any of the creditors or

residuary beneficiaries of the trust operations until the Petitioner sought in the year 1970 to terminate the arrangement, liquidate the properties, pay the remaining unpaid creditors, and distribute to the residuary beneficiaries all remaining monies or property. Termination of the trust was opposed by the respondent beneficiaries, being the heirs and devisees of the debtor, he having died in 1960, and by certain creditors whose claims have since been paid and extinguished.

The plan of arrangement itself specifically provided:

> "6.02 If all the secured and unsecured creditors are not paid within ten (10) years from the date of the approval of the proposed arrangement, then the court may terminate this trust."

It was represented to the creditors that the plan would be terminated in any event after it had been in force and effect for ten (10) years if all creditors had not been paid at that time.

The Petitioner submitted his resignation as trustee and was directed to file a final account. It was not until Petitioner sought to have the plan of arrangement terminated and the creditors paid that a question was raised by anyone regarding his management and operation of the trust.

The vast majority of the remaining unpaid creditors supported termination of the plan of arrangement, liquidation of the properties, and distribution.

The respondents sought to surcharge the Petitioner

covering a period from inception of his trusteeship until his resignation as trustee and sought to defeat the remuneration provided for in his contract of employment and approved by the bankruptcy court.

At the time Petitioner entered into the employment contract with the debtor, the debtor had in his employ a trusted bookkeeper who had been employed by the debtor and his family for more than ten (10) years.

The bookkeeper was secretary-treasurer of Healdton Petroleum Company, 57% of the stock thereof being owned by the debtor. Bookkeeper was named a trustee in several trusts created by debtor and by members of debtor's family. Bookkeeper handled the books, records and accounts of debtor's wife and son, the latter being one of the respondents.

Bookkeeper was named a co-executor in the Last Will and Testament of debtor and was secretary-treasurer of a charitable foundation created and operated by debtor and the respondent son.

Bookkeeper was treasurer of the Seventh Day Adventist Church in Ardmore, Oklahoma, a church to which debtor gave considerable support, and the charitable foundation was created in the name of this church.

In short, bookkeeper was a longtime, trusted employee of the debtor's family and the family reposed great dependency, trust and confidence in bookkeeper for the handling of their business and financial affairs. Bookkeeper was continued as a trusted employee by the trust.

In the year 1969, the CPA's retained by Petitioner throughout his tenure discovered in the course of their regular, annual examination of the books and records that bookkeeper had embezzled trust funds.

The Petitioner immediately caused a complete fraud audit of the books of the trust from its inception. The fraud audit revealed an embezzlement by bookkeeper totaling $53,340.17. The Petitioner immediately reported same to the Court and took the following actions:

1. Filed petition for summary judgment against bookkeeper and procured an order enjoining bookkeeper from disposing of any of his property;

2. Filed application and secured an order for sale of assets of bookkeeper;

3. Filed application for summary judgment against bookkeeper;

4. Secured an order for citation and setting for hearing application for summary judgment against bookkeeper and issuing citation thereon;

5. Secured an order for sale of assets of bookkeeper;

6. Secured an order and judgment for restitution against bookkeeper;

7. Proceeded to sell bookkeeper's assets, pay encumbrance thereon, and remit proceeds to the Bankruptcy Court;

8. Filed application for approval of sale of bookkeeper's property; and

9. Obtained order approving the sale of bookkeeper's property.

In excess of $40,000.00 of the funds embezzled from the trust by bookkeeper were converted and deposited by bookkeeper to his own personal account in a local bank which had also been designated and approved by the Bankruptcy Court as the depository bank for the trust receipts. The depository bank permitted these defalcations to take place until the Petitioner discovered the same.

Petitioner took the following actions against the depository bank:

1. Made application to the Bankruptcy Court for authority to institute suit against the depository bank;

2. Procured order authorizing and directing the Petitioner to institute action against the depository bank in the State District Court;

3. Commenced action in the District Court of Carter County, Oklahoma, pursuant to the Court's order;

4. The Petitioner, pursuant to the Court's direction, proceeded to trial in the State Court and procured a jury verdict and judgment in favor of the trust;

5. Petitioned the Bankruptcy Court for authority to perfect an appeal on the judgment of the State District Court on the issue of allowance of interest on the embezzled funds; and

6. Perfected such appeal to the Supreme Court of the State of Oklahoma and procured a reversal of the State Court's refusal to grant judgment for interest

and costs of pursuit on the embezzled funds. See *The First National Bank and Trust Company of Muskogee, Oklahoma, Trustee of the Roy M. Johnson Creditors' Trust, v. Exchange National Bank and Trust Company, Ardmore, Oklahoma,* 517 P.2d 805 (Okla. 1973).

The Petitioner's diligent actions as enumerated above effected a recovery for the trust in the total sum of $93,883.27. The trust paid from these recoveries fraud audit accounting expenses and all legal fees, costs and expenses incurred, leaving a net recovery of $47,718.20.

The First National Bank & Trust Company of Muskogee, Oklahoma, one of the respondents herein, succeeded Petitioner both as trustee and as plaintiff in the State Court action prior to its trial. The depository bank in the defense of the State Court action placed directly in issue the question of Petitioner's negligence by affirmatively pleading the statute of limitations as an affirmative defense and contended that the successor trustee and respondent herein could not recover for any sums embezzled by the bookkeeper more than two (2) years prior to the institution of the action (which essentially constituted all of the sums embezzled) by reason of the failure of Petitioner to earlier discover the embezzlements through the exercise of due diligence and by failing to properly supervise the activities of the bookkeeper.

The State Court exhaustively instructed the jury on these defenses and clearly defined the standard of diligence and care required of Petitioner in order to re-

turn a verdict for the trust (Appendix G, infra, pp. A-52 - A-54).

All of the respondents herein were either parties to the State Court action or in privity therewith, and all parties were present in open court when the Petitioner was authorized, ordered and directed to initiate the State Court proceedings.

The District Court, after the conclusion of all collateral proceedings and upon consideration of all evidence adduced in the surcharge proceedings, including a complete review of the entire record, and upon submission of briefs by all parties and presentation of oral argument, entered its findings of fact and conclusions of law in open court, and judgment was entered thereon denying the attempts to surcharge Petitioner. The findings of fact by the District Court were, in part, as follows:

1. That a bankruptcy court sits as a court of equity and governs itself in accordance with the usual principles of equity;

2. That the State Court action squarely placed in issue whether or not the Petitioner was guilty of neglect in handling the affairs of the bankrupt estate and particularly in reference to the bookkeeper's defalcation as follows:

> "It appears without question that that particular point was squarely at issue in that case, the pleadings in that case disclose this; the verdict of the jury was returned with this point presented to it; the matter was finalized in the State Courts, with a determination which had to be made in this case

> as far as the [bookkeeper's] defalcations are concerned, [petitioner] was not guilty of either an improper motive or a failure to exercise diligence or failure to exercise reasonably or that he had been guilty of such gross neglect in the matter."

3. There was nothing in the record to indicate fraud or dishonesty on the part of the Petitioner;

4. That the successor trustee (one of the respondents herein) and those in privity with the successor trustee (the remaining respondents herein) were precluded from taking a position diametrically opposed and completely inconsistent with the position they took in the State Court;

5. That the legal principle given various names such as judicial estoppel, collateral estoppel, and res judicata, would not permit the assumption of inconsistent and contradictory positions so as to permit playing fast and loose with the Court;

6. That aside from the application of the doctrine of collateral estoppel, the evidence and record would not support a finding that the defalcations were brought about in such a fashion that a reasonably prudent person would have detected them, and that such finding by the District Court was supported by the jury of twelve (12) people in the State case that had the same matter before it. That under the Oklahoma Trust Act, the Bankruptcy Act, and the terms of the plan of arrangement itself, the Petitioner was empowered clearly with the authority to engage a bookkeeper and secretary in the operation of the creditors' trust;

7. That being a court of equity which brings into play the doctrines of ratification, acquiescence and laches;

8. That although the trust had not been an ideal operation, any fault, if it may be termed that, could not be placed singularly on Petitioner; and

9. That under all of the circumstances, the request that the Petitioner be surcharged was without merit and must be denied.

The respondents then appealed from the District Court's findings of fact, conclusions of law, and judgment rendered thereon, and the Court of Appeals rendered the decision below for which review is sought.

REASONS FOR GRANTING THE WRIT

I.

The accepted and usual application in judicial proceedings of the clearly erroneous rule (Rule 52 [a] of the Rules of Civil Procedure for the United States District Courts) is so far departed from in the decision below of the Court of Appeals that same constitutes plain and simple error.

The decision below of the Court of Appeals is error in itself. Rule 52 (a) of the Rules of Civil Procedure for the United States District Court is so far departed from that the decision totally ignores it. This is so even though Petitioner extensively briefed its applicability in the Court below.

The decision below of the Court of Appeals decides

all of the factual issues "de novo" and in the process sets aside every finding of fact reached and concluded by the District Court. This is clearly not the function of the reviewing court. The Court of Appeals follows and promulgates a rule that "there was at least some evidence" (Appendix A, p. A-14), and further invokes findings of its own in regard to the lower court's findings in such fashion as, " . . . the crowning blow was the court's ruling . . .", (Appendix A, p. A-7) and "the trial court did not, however, come to grips with the issue.;" (Appendix A, pp. A-14, 15) and "these were not scrutinized in detail by the court, and had they been, it is doubtful that they would have been treated as de minimis." (Appendix A, p. A-16). The decision below never deals with or confronts the "clearly erroneous" rule, but the reviewing court becomes a trier of the facts and refuses to accept any of the findings of the Trial Court.

The function of the reviewing court was not to review the evidence de novo; rather, it was bound to accept the District Court's findings of fact unless convinced they were clearly erroneous. The reviewing court could not reach an opposite result on each finding of fact entered by the able and learned Trial Court without completely disregarding the existence of and application of the "clearly erroneous" rule.

A review of the entire record will show that the decision by the Court of Appeals below completely ignored and disregarded affirmative and probative uncontradicted evidence presented by Petitioner in the surcharge proceedings that support the findings of fact

and conclusions of law entered by the District Court such as:

1. Uncontradicted evidence by witnesses presented by Petitioner that the overall operation of the trust and expenses incurred were reasonable; and

2. That the type of embezzlement carried on by the bookkeeper was a very difficult one to detect and discover.

A most recent pronouncement by this Court that the application of Rule 52 (a) of the Federal Rules of Civil Procedure is found in *Zenith Radio Corporation v. Hazeltine Research, Inc., et al.*, 395 U. S. 100, (1969). This Court succinctly states at p. 123 as follows:

> "In applying the clearly erroneous standard to the findings of a district court sitting without a jury, appellate courts must constantly have in mind that their function is not to decide factual issues de novo. The authority of an appellate court, when reviewing the findings of a judge as well as those of a jury, is circumscribed by the deference it must give to decisions of the trier of the fact, who is usually in a superior position to appraise and weigh the evidence. The question for the appellate court under Rule 52 (a) is not whether it would have made the findings the trial court did, but whether 'on the entire evidence [it] is left with the definite and firm conviction that a mistake has been committed.' " (cases cited)

The "clearly erroneous" rule was been universally and uniformly construed and applied throughout the federal judiciary to prevent reviewing appellate courts

from becoming triers of fact and entering de novo findings. The Court below never confronted or faced that restriction upon its function by ignoring it.

In the case of *Campbell v. Barsky* 265 F. 2d 463 (5th Cir. 1959) it is stated:

> "Conflicting inferences were open to the trier. The court drew those substantially exonerating Barsky. For us to overrule them requires that we hold as a matter of law either that reasonable men could not possibly make such a finding, or that the result leaves us with a conviction that an injustice has been done." (cases cited) Id. at 466.

Lewis Mach. Co. v. Aztec Lines, 172 F. 2d 746 (7th Cir. 1949) at page 748, states:

> "In considering this record, we look only to the evidence most favorable to the district court's findings and such reasonable inferences as may be drawn from such evidence."

The applicable principles of law governing an appellate court reviewing a district court judgment are clear. It is, therefore, not necessary to cite numerous authorities. It may be stated generally that the findings of the trial court will not be set aside unless clearly erroneous (see numerous authorities so holding annotated at Federal Rules of Civil Procedure, Rule 52[a], 28 U.S.C.A., Note 93).

II.

The treatment and application of *Mosser v. Darrow*, 341 U. S. 267 (1951), by the Court of Appeals in its decision below, is an enlargement upon this Court's holding in *Mosser* to an extent of effectuating an overruling thereof and creates a rule of strict liability for trustees in bankruptcy.

This Court, in *Mosser v. Darrow*, 341 U. S. 267 (1951), established a rule of liability for trustees in bankruptcy who knowingly, willfully, and deliberately engage in self-dealing by setting up of an interest in employees adverse to that of the trust.

The decision below directly conflicts with *Mosser* and erroneously applies *Mosser* to the instant action involving a faithful and unknowing trustee who was betrayed by a bookkeeper of the bankrupt debtor and his family.

The *Mosser* case is supportive of the Petitioner. The Court of Appeals applies the doctrine of *Mosser* to impose strict liability upon the faithful and unknowing trustee. To treat *Mosser* as similar in any respect to the instant case is to enlarge upon *Mosser* to the point of overruling its express holding therein. *Mosser* itself expressly confines its holding to trustees in bankruptcy who *willfully* and *knowingly* permit profits to be made from the operations of the trust by third parties.

Mosser has been consistently applied in decisions of this Court and other courts of appeal to those instances where a fiduciary, such as a trustee in bankruptcy, is engaged in *willful* and *deliberate* conduct adverse to

the interest of the trust. Not only was the Petitioner a faithful and honest trustee, free of any wrongdoing, but he had no knowledge of or any reason to suspect the criminal conduct of the long-time trusted employee of the bankrupt.

The annotation commencing at 95 L. Ed. 934 clearly reflects the sphere of application of *Mosser* in the title thereof, to-wit:

> "Rule requiring trustee to refrain from self-dealing as applied to trustees and receivers appointed under the Bankruptcy Act.

Heretofore, *Mosser* has been applied within the bounds and framework of its holding in the following cases: *Blau v. Lehmann*, 368 U. S. 403 (1962). (Justice Douglas, in dissent, discusses and quotes from *Mosser* in a case dealing with "Short swing" profits earned by a partnership from dealings in stock of a corporation in which the defendant partner was a director); *SEC v. Capital Gains Research Bureau*, 375 U. S. 180 (1963), (*Mosser* case cited in this case dealing with prohibited transactions by investment advisers under securities regulations); *Linkletter v. Walker*, 381 U. S. 618 (1965) (*Mosser* cited in dissenting opinion by Justice Black as having created new rule imposing heavy financial liability on a trustee in bankruptcy for acts which he performed which at the time he performed them had been perfectly valid under the law, i.e. that *Mosser* should not be applied retroactively); *Donovan & Schuenke v. Sampsell*, 226 F. 2d 804 (9th Cir. 1955), (*Mosser* cited and quoted from to support rule that trustee will be liable if an agent or em-

ployee is permitted to do an act which he could not do or authorize, but was forbidden by the reason of his fiduciary relationship from doing such act); *In re TMT Trailer Ferry, Inc.*, 334 F. 2d 118 (5th Cir. 1964), (*Mosser* cited for authority that equity must exact from its trustee forbearance of all opportunities to advance self-interests); *United States v. Mason*, 412 U. S. 391 (1973), (cites *Mosser* for authority that when trustee is in doubt as to what procedure to follow that the proper course is to conform his conduct to the instructions given him by the courts).

The decision of the Court of Appeals below applies *Mosser* erroneously. The decision below refers to a similarity between the cases when there is none. The decision below attempts to analogize the *Mosser* trustee's failure to file reports with the petitioner's failure to check upon, anticipate, and earlier discover the malfeasance of the bookkeeper. The petitioner filed all required statements and reports and, through his CPA's, *did discover* the defalcations and move to recover the losses for the trust. If the *Mosser* doctrine is applied to the petitioner, then the result is clear that the holding of this Court in *Mosser* is extended and enlarged to create a doctrine of strict liability for trustees in bankruptcy.

The *Mosser* rule supports petitioner rather than creating a rule for imposition of absolute and strict liability without regard to fault. This Court stated in *Mosser*, 341 U. S. 267 at 272 as follows:

> "It is argued here, and appears to have been the view of the Court of Appeals, that principles of

> negligence applied and that a trustee could not be surcharged under many decisions unless guilty of 'supine negligence.' We see no room for the operation of the principles of negligence in a case in which conduct has been knowingly authorized. This is not the case of a trustee betrayed by those he had grounds to believe were trustworthy, for these employees did exactly what it was agreed by the trustee that they should do. The question of whether he was negligent in not making detailed inquiries into their operations is unimportant, because he had given a blanket authority for the operations. The liability here is not created by a failure to detect defalcations, in which case negligence might be required to surcharge the trustee, but is a case of a willful and deliberate setting up of an interest in employees adverse to that of the trust."

The decision below purports to acknowledge that the standard to be applied to petitioner is founded in principles of negligence and that the standard or measure of care, diligence and skill is that of an ordinarily prudent man in the conduct of his private affairs. The decision below, although recognizing the standard that should have been applied to petitioner, applies the *Mosser* rule inequitably to impose strict liability with consistent disregard for the true holding of *Mosser*. The decision below is inconsistent upon its face but clear in its result of strict liability.

The decision below acknowledges that the trustee in *Mosser* filed but one account in eight (8) years of trusteeship but ignores that petitioner filed and mailed annual reports with the Court and to all creditors and

beneficiaries as directed by the Bankruptcy Court itself during each year of his approximate ten (10) year trusteeship.

The decision below analogizes the *Mosser* trustee's knowledge of self-dealing and conflict of interest with a failure to discover defalcations. The decision expressly imposes a duty to "ascertain the facts"—i.e. strict liability; the decision below expressly imposes an obligation to detect misconduct and wrongdoing so as to prevent injury to the trust—i.e. strict liability; the decision below prohibits delegation of duties to others—i.e. strict liability; the decision below holds that the petitioner should have discovered the embezzlement and, thus, should be surcharged—i.e. strict liability; the decision below holds the petitioner responsible on what it refers to as "circumstantial evidence"—i.e. strict liability; the decision below concludes that the petitioner will not be heard to say he did not "anticipate the misconduct" of an employee—i.e. strict liability.

There is but one clear result of the decision below. The *Mosser* rule has been expanded by the decision below to impose liability upon trustees in bankruptcy without regard to fault and knowledge. In so doing, it violates the very holding of *Mosser* that the doctrine or rule prescribed therein is restricted to trustees who knowingly, willfully, and deliberately permit self-dealing with trust property, either to their own benefit or to the benefit of third parties. *Mosser* did not prescribe the "ground rules" for trustees such as petitioner.

There can be but one net effect from such a misapplication, enlargement, and overruling of *Mosser*. That

effect is that individual trustees in bankruptcy must now serve with absolute fear of strict liability or not serve at all. Naturally, the latter will prevail in most instances.

III.

The decision by the Court below is in conflict with applicable decisions of the Supreme Court of the State of Oklahoma and the Tenth Circuit Court of Appeals on the matter of the application of the doctrine often interchangeably referred to as collateral estoppel, judicial estoppel, res judicata, and preclusion against taking inconsistent position.

The Petitioner's alleged negligence was an issue in the State case against the depository bank. The negligence of the Petitioner was directly involved. The State Court instructed the jury that it could only find for the Petitioner if the fraud could not have been discovered prior to the date it was discovered by the use of reasonable diligence.

The decision of the Court of Appeals below states:

> "Examination of the instructions fails to reveal that the jury was told that it could only find for the plaintiff if the fraud could not have been discovered with reasonable diligence."

An examination of the instructions reveals directly to the contrary (Appendix G, infra, pp. A-52 - A-54).

The decision below precludes Petitioner from utilizing collateral or judicial estoppel upon the premise

that Petitioner was occupying a different role or relationship in the State action.

The facts and issues tried were the same facts and issues and the person was the same person. Also, the parties are the same parties except for the depository bank in the State Court case. During the period of the trust, the true facts occurred. Those true facts can never be changed. In the State Court, the jury examined those facts as presented by the successor trustee (a respondent herein). That jury found that under those facts the Petitioner was not negligent in failing to detect the bookkeeper's defalcations or in supervising him. The doctrine of collateral estoppel prevents those respondents and those in privity therewith to now say that those exact same facts support a finding that the exact same person was negligent. The degree and standard of care is the same in both cases.

To allow such a change in position by the respondents because their interests are now served by it violates the doctrine.

The parties who sought to surcharge the Petitioner consisted of the creditors, residuary beneficiaries, and successor trustee in bankruptcy. The decision below acknowledges the successor trustee in bankruptcy, both as trustee and as plaintiff in the State case against the depository bank. The decision below further acknowledges that at the trial of the matter in the State Court the successor trustee prevailed. The decision below acknowledges that the Petitioner's alleged negligence was an issue in the State case against the depository bank.

The decision below then proceeds to irreconcilably conflict its own findings and recitation of the facts to conclude that the issue of Petitioner's negligence was not litigated when, in fact, it was.

The successor trustee, the trust, the creditors thereunder, and the residuary beneficiaries were either all parties to the state action or in privity with parties to the action so as to be barred, estopped, and precluded from thereafter taking a position that Petitioner was negligent in the handling and managing of the trust and its employees. All of such parties and litigants are not to be permitted, either by passive consent or by affirmative action, to lead a court to find a fact one way and then contend in another judicial proceeding that the same facts should be found otherwise. Such parties and litigants are deemed to be "playing fast and loose with the courts" under the applicable authorities and well-settled decisions of the U. S. Supreme Court, State of Oklahoma and the 10th Circuit Court of Appeals.

The decision below permits the very thing the doctrine of collateral estoppel has been applied heretofore to prevent. The decision below is in irreconcilable conflict with universal applications of the doctrine of collateral estoppel and can in no wise be even reconciled within its own confines to support the result reached in precluding Petitioner from invoking the doctrine.

The decision rendered by the Court of Appeals below is in direct conflict with the following decisions of the 10th Circuit Court of Appeals and other Courts of Appeal, to-wit:

Queenan v. Mayes, 90 F. 2d 525 (10th Cir. 1937); *Eads Hide & Wool Company v. Merrill*, 252 F. 2d 80 (10th Cir. 1958); *Scarano v. Central R. Co. of New Jersey*, 203 F. 2d 510 (3rd Cir. 1953); *United States v. Katy Drug Co.*, 150 F. 2d 681 (8th Cir. 1945); *Hughes v. Ward Oil Corp.*, 124 F. 2d 393 (5th Cir. 1942); *Chandler v. McKerral*, 68 F. 2d 343 (7th Cir. 1934).

This decision also fails to apply the general doctrine of collateral estoppel even though it has been adopted by the United States Supreme Court in *Davis v. Wakelee*, 156 U. S. 680 at page 689 (1895):

> "It may be laid down as a general proposition that, where a party assumes a certain position in a legal proceeding, and succeeds in maintaining that position, he may not thereafter, simply because his interests have changed, assume a contrary position, especially if it be to the prejudice of the party who has acquiesced in the position formerly taken by him."

Also see *The Philadelphia, Wilmington, and Baltimore R.R. v. Howard*, 54 U. S. 307 (13 How. 305) (1851).

The decision below incorrectly applies the doctrine of collateral estoppel even though its application is clearly required by the following cases, to-wit:

A. GENERAL AUTHORITIES AND TREATISES

31 Corpus Juris Secundum, Estoppel, §'s 115-117; 57 Harvard Law Review 98; 59 Harvard Law Review

1132; Restatement of the Law, Judgments, pages 389-390; 31 A.L.R. 3d 1044.

B. OKLAHOMA SUPREME COURT DECISIONS

Magnolia Petroleum Company v. Ouart, 192 P. 2d 698 (Okla. 1948); *Lewis v. Aubrey*, 404 P. 2d 1005 (Okla. 1965); *Hankins v. District Court of Jackson County*, 424 P. 2d 26 (Okla. 1967); *Wilkey v. Southwestern Greyhound Lines, Inc.*, 322 P. 2d 1058 (Okla. 1958); *Laws v. Fisher*, 513 P. 2d 876 (Okla. 1973); and *Anco Mfg. & Supply Co., Inc. v. Swank*, 524 P. 2d 7 (Okla. 1974).

C. OTHER STATE COURTS

Michaelson v. Simula, 250 N. W. 264 (Michigan 1933); *Peterson v. Strayer, et al.*, 237 N. W. 667 (Nebraska 1931); *Bernhard v. Bank of American Nat. Trust & Savings Ass'n.*, 122 P. 2d 892 (California 1942); *Perkins v. Benquet Consol. Mining Co.*, 132 P. 2d 70 (DCA, First District, Div. 1, Calif. 1942); *Krause v. Krause*, 26 N. E. 2d 290 (N. Y. Ct. App. 1940); *Bahler v. Fletcher*, 474 P. 2d 329 (Ore. 1970); and *Murphy v. Northern Colorado Grain Company*, 488 P. 2d 103 (Colo. 1971).

IV.

The Petitioner should not be subject to surcharge for any of the reasonable expenses incurred in the operation and management of the trust because he complied with and performed in accordance with the bankruptcy court's direction and applicable law; principles of equity apply herein and should have protected Petitioner.

The Petitioner herein was appointed trustee in bankruptcy under Chapter XII of the Bankruptcy Act dealing with real property arrangements by persons other than corporations. Title 11, U.S.C., §845, provides as follows:

> "The trustee or the debtor in possession shall have the power, upon authorization by and subject to the control of the court, to operate the business and manage the property of the debtor during such period, limited or indefinite, as the court may from time to time fix, and during such operation or management shall file reports thereof with the court at such intervals as the court may designate."

The Plan of Arrangement approved by the Bankruptcy Court vested the Petitioner with the powers enumerated in the Oklahoma Trust Act in addition to the powers specifically enumerated in the Plan of Arrangement itself (Appendix F, infra, A-50 - A-51).

The Petitioner herein complied at all times with the Bankruptcy Act and the designation of the Court as to the filing of statements and reports. The Petitioner operated the business and managed the property of the

debtor during the period of time fixed by the Court and during such operation and management filed reports thereof with the Court at the intervals as the Court had designated. Petitioner did so faithfully and diligently in accordance with the Bankruptcy Act and the Plan of Arrangement.

The decision below now imposes a new duty upon the Petitioner, retroactively. Although the Petitioner complied with the law and the Court's designations under Title 11, U.S.C., §845, without any objection for a period of approximately ten (10) years, the decision below refuses to apply equitable principles and afford Petitioner protection of the law. The reasonable expenses incurred were monthly reported to the Court and annually to the Court, creditors, and beneficiaries without a single objection. The decision below now proposes that the Petitioner should have given notice of a hearing and obtained annual approval of the reports at such hearing.

At no time, did anyone raise an objection to the Petitioner's operation and management of the debtor's business and property until after the defalcations by the bookkeeper were discovered and the trustee subsequently sought to terminate the trust in accordance with the court-approved Plan of Arrangement. It is only the Court of Appeals in the decision below that has charged the Petitioner with "sketchy reports".

It was held in the case of *White v. Murtha*, 343 F. 2d 831 (5th Cir. 1965), as follows:

> "Principle that bankruptcy is equitable will not be construed so as to require debtor in possession

to petition court for authorization for every expense incident to operation of business."

And, in the body of the opinion, the court said at page 833:

> " . . . Although it is true that such authority was not specifically granted, we do not think it was necessary with respect to such ordinary operating expenses as liquor inventory, fire insurance and wages. The debtor in possession was authorized to operate the business, and such operation is under the control of the court, and the debtor in possession limited in his use of the property. 8 Collier on Bankruptcy §6.30 [4]. However, as has been many times said, bankruptcy is equitable, and it would be contrary to equitable doctrines to so construe the stated principle as to require that a debtor in possession must petition the court for authorization for every expense incident to the operation of the business."

In *In re Cook*, 28 F. 2d 521 (D.Ct.D. Mass. 1928), the court said in the body of the opinion at pages 522, 523:

> "Moreover, general notice was sent to all creditors of the dividend order, which included the disbursements here in question. It is said by the administrator that no such notice was sent to or received by him or his intestate. Accepting this as true, it does not invalidate the order. It would perhaps make it proper to allow review, notwithstanding the 10-day rule, if the parties seeking review were diligent, and such course appeared advisable in the interest of justice. Here nearly 10 months elapsed after the order, during which time the petitioners took no action, and the trustee made the disbursements thereby ordered.

> *"The items in controversy must be regarded as having been definitely closed, and as not reopened to dispute by reason of their inclusion in the trustee's final account. To hold otherwise would put trustees in bankruptcy in the position of making all payments from an estate absolutely at their peril, on the chance that, if objections were made to the final account and sustained, the trustee would have to refund the payments, or, in the alternative, that a great number of notices would have to be sent out, involving much labor, expense, and delay in the administration of estates. In view of practical importance of the point, I have submitted this opinion to Judge Lowell and Judge Brewster, and I am authorized to say that they concur in it."* (emphasis ours)

For the trustee to have gotten an order of the court for each expenditure in operating the trust would be an intolerable burden both upon the trustee and the court. *There is no requirement, either in the plan of arrangement or the Bankruptcy Act, that the trustee make an annual accounting and that hearing be had and approved by the court.* The requirement is only that the trustee make and file reports thereof at such intervals as the court may designate. Thus, all parties were kept informed of the expenditures being made by the former trustee in connection with the operation of the trust.

It would have been extremely inequitable to have surcharged the Petitioner for these expenditures under the record herein because it would be contrary to the evidence presented to the lower court. If the creditors and residual beneficiaries had any objection to

these expenditures, they should have made a timely objection thereto so that the former trustee could be informed as to their position in these matters.

CONCLUSION

This Court should grant this Petition because the Court below ignored the "clearly erroneous" rule and refused to consider the evidence, much of which was uncontradicted, supporting the trial court's judgment. The court below sought and considered only evidence it could find that could be construed to support its de novo judgment. This Court should not allow the Opinion below to become precedent in the 10th Circuit.

The Opinion below, should it become precedent, will surely cause potential trustees to refuse to shoulder the risk of being subjected to the strict liability for acts of employees of the trust. The lower court's potentially burdensome holding is particularly alarming when a trustee does not have knowledge of and is not negligent in, detecting the defalcation.

The distinction made by the court below that collateral estoppel did not estop Respondent because the Petitioner in one case appeared as trustee, and appeared in another case individually, will improperly change the substantive law of collateral estoppel. The Opinion will encourage a party to represent the same facts differently in different cases.

The court below failed to apply equitable principles in this case, resulting in plain error.

PRAYER

WHEREFORE, premises considered, Petitioner prays that this Petition for a writ of certiorari be granted and that Petitioner have the relief to which he is justly entitled.

Respectfully submitted,

Henry W. Simon
John W. Hughes
SIMON & SIMON
800 Baker Building
110 West Seventh Street
Fort Worth, Texas 76102

J. D. DeBois
O. L. Peck, Jr.
DEBOIS, PECK & SHERRILL
P. O. Box 1427
Duncan, Oklahoma 73533
Attorneys for Petitioner

By ----------
John W. Hughes

CERTIFICATE OF SERVICE

On this ..... day of July, 1975, the undersigned certifies that three exact copies of this Petition have been directed by United States Mail, postage prepaid, to each of the following addressees, to-wit:

Mr. Andrew Wilcoxen
Wilcoxen, Lunn, Mayes & Cate
P. O. Box 1842
Muskogee, Oklahoma 74401

Mr. A. Carl Robinson
Robinson, Summers & Locke
213 North 3rd Street
Muskogee, Oklahoma 74401

same being attorneys of record for the respondents herein.

John W. Hughes

APPENDIX A

Opinion of the United States Court of Appeals for the Tenth Circuit entered May 29, 1975.

Filed May 29, 1975
Howard K. Phillips, Clerk, United States Court of Appeals, Tenth Circuit

UNITED STATES COURT OF APPEALS
TENTH CIRCUIT

Nos. 74-1373 and 74-1374

IN THE MATTER OF ROY M. JOHNSON, Debtor.

OTEY JOHNSON, Individually and as Trustee, JOHN A. BUNN, ED GALT, OKLAHOMA BOOK AND BIBLE HOUSE, C. W. MARSH, OKLAHOMA CONFERENCE CORP. OF SEVENTH DAY ADVENTISTS, and ARDMORE HOSPITAL (Creditors and Residuary Beneficiaries),

Appellants,

v.

GORDON D. CLARK, et al.,

Appellees.

THE FIRST NATIONAL BANK AND TRUST COMPANY OF MUSKOGEE (Trustee in Succession of the Roy M. Johnson Trust),

Appellant,

v.

GORDON D. CLARK, et al.,

Appellees.

Appeal from the United States District Court
for the Eastern District of Oklahoma
(D.C. No. 8330 Bkr.)

Andrew Wilcoxen of Wilcoxen, Lunn, Mayes & Cate, Muskogee, Oklahoma, for Appellants Johnson, et al.

A. Carl Robinson of Robinson, Summers & Locke, Muskogee, Oklahoma, for Appellant The First National Bank and Trust Company of Muskogee, Trustee in Succession.

J. D. Debois of Debois, Peck & Sherrill, Duncan, Oklahoma, and Henry Simon, Sr. of Simon & Simon, Fort Worth, Texas (O. L. Peck, Jr. of DeBois, Peck & Sherrill and John W. Hughes of Simon & Simon, on the brief), for Appellee Gordon D. Clark.

Before LEWIS, Chief Judge, and BREITENSTEIN and DOYLE, Circuit Judges.

DOYLE, Circuit Judge.

The main issue presented is whether the trustee of a creditors trust established pursuant to Chapter XII of the Bankruptcy Act is to be surcharged for substantial losses to the trust, which losses resulted from defalcations of the bookkeeper; the losses amounted to about $50,000 and occurred during a period starting in 1960 and continuing to 1969.

Appellee Clark was the trustee who hired Billingsley, the bookkeeper. The latter received all of the income of the trust and had absolute control over all expenditures. Notwithstanding that the embezzlements and the fraudulent peculations were regularly

carried out, the trustee failed to check on the bookkeeper's work and never discovered the losses. Finally, accountants, while preparing income tax returns, accidentally became aware of the wrongdoing.

In an action by the beneficiaries seeking to surcharge the trustee for the deficiencies in his accounts, the trial court denied relief. The beneficiaries and creditors have appealed.

Following the filing of a petition for a Chapter XII arrangement by Roy Johnson on August 5, 1958, the United States District Court for the Eastern District of Oklahoma approved the proposed arrangement and confirmed the same on May 11, 1960. At that time, Clark was appointed trustee. The arrangement required the trustee to continue the business, submit a profit and loss statement each month, pay the income from mortgaged property to secured creditors and to pay the remaining income to the unsecured creditors. In 1961 the court ordered the trustee to submit annual audits to the court and cr[illegible]ors. In practice these did not involve a detailed in[illegible]stigation and did not reveal the facts.

As of November 1962, the working interests of the trust had been sold, the secured creditors had been paid and the trust retained only passive royalty interests. Distributions to the unsecured creditors were made on July 31, 1962, August 15, 1962, September 11, 1963 and July 31, 1968. The resulting reduction of debt amounted to approximately 30%.

Besides being trustee Clark, who was a geologist,

operated his own business and a partnership with his father. All were conducted in the same office. Billingsley, the embezzling bookkeeper and the secretary, performed services for all three businesses.

The undisputed evidence showed that Clark filed the monthly statements and the annual reports, sending copies to the creditors. However, no hearings were ever held on the sufficiency of these nor was action taken by the court giving approval to them. At the same time, neither the creditors nor the residuary beneficiaries objected.

The annual reports were unaudited. They were prepared by the accountants from figures given by Billingsley. It was not until 1969 that these accountants discovered some discrepancy leading to further investigation and revelation that Billingsley had been embezzling money of the trust from its inception. He had both altered and forged checks on a regular basis. For example, not infrequently he raised his salary checks by $1,000. His other practice was to convert royalty checks payable to the trust. He would endorse them on behalf of the trust and then make deposits in his personal account. All of these defalcations totaled over $50,000.

After discovery of the wrongdoing, Clark dismissed Billingsley, enjoined him from disposing of his property and proceeded to get a judgment against him. After this, Billingsley's assets were sold and the proceeds were deposited in court. The trustee also obtained permission to sue the Exchange National Bank

and Trust Company of Ardmore.[1] This was the bank which had received trust checks deposited in the account of Billingsley.

The trust had been intended at the time of its creation to continue for 10 years. Therefore, on April 28, 1970, the trustee sought an extension of time in order to pursue the Billingsley recovery. In conjunction with this, however, he requested an order allowing liquidation of the assets and termination of the trust. The beneficiaries and some of the creditors objected to this. As a result a hearing was held in October in which the court directed the trustee to file a preliminary final accounting. Soon thereafter, in January 1971, the objecting creditors and beneficiaries applied to the court to surcharge the trustee for the deficiencies attributable to Billingsley and also for alleged excessive administrative expenses. In addition, a request was made that the trustee be denied the additional compensation which the plan would have given to him.[2]

Following another hearing in February the court continued the arrangement for a year. The court also ordered Clark to file a final report. Delay of the surcharge determination was also ordered.

On March 1, 1971, the First National Bank and

---

[1]Both the trust account and Billingsley's account were kept with the Exchange National Bank. Billingsley would endorse the checks properly, but then simply deposit them in his personal account.

[2]The arrangement provided that when the trust was terminated and all the creditors were paid, Clark would be entitled to 15% of the residue.

Trust Company of Muskogee succeeded Clark as trustee, and as the plaintiff in the suit against the Exchange National Bank. At the trial of this matter in February 1972 the trustee Bank prevailed.

A hearing on Clark's final report and motion for discharge was held in August 1971. After that, the case was taken under advisement, and on November 21, 1972, Judge Langley entered an order surcharging Clark in the amount of $157,185.99. However, on January 2, 1973, this order of surcharge was vacated. Another hearing was held on April 24. Following this briefs were submitted, but before a decision could be made Judge Langley died. The case was then tried by Judge Daugherty on the record. This trial was held on April 19, 1974, at which time oral arguments were made, and soon thereafter, on May 3, 1974, Judge Daugherty entered the present order which is now being reviewed in which he denied the surcharge and approved the final account of Clark.

The trial court ruled:

1) That the judgment allowing the estate to recover against the Exchange National Bank somehow barred or prevented a surcharge in these proceedings. The court's reasoning was that the creditors and beneficiaries were barred from asserting a position inconsistent with that maintained in the prior proceeding;

2) The court was uncertain as to whether a reasonably prudent person could have detected Billingsley's conversions;

3) The court refused to surcharge for excessive administrative costs on the ground that it felt unable to conclude improper management by Clark warranting surcharge;

4) The court felt that the objectors were barred because of their failure to object to the reports which were filed regularly. The ruling was that they had either ratified or acquiesced;

5) The beneficiaries and creditors were barred by laches. They had not objected and thus it would be unfair to surcharge the trustee after passage of the years involved;

6) The court held that the misuse of the telephone and the making of gifts out of trust funds was de minimis;

7) The accounting expenses and legal expenses occasioned by the substantial losses to the trust were not chargeable under the totality of the facts; finally, the crowning blow was the court's ruling that the trustee was entitled to his 15% of the residue of the estate. All of these rulings are challenged on this appeal.

I.

The standard applicable to the surcharge of a bankruptcy trustee is negligence. This was established in the case of Mosser v. Darrow, 341 U.S. 267 (1951). As in the case at bar, the trustee there did not make any personal profit. His wrongdoing consisted of allowing key employees to profit personally by trading

in securities of the subsidiaries of the debtor corporation. Darrow was appointed reorganization trustee in 1935 for the common law trusts. Johnson and Kulp were employed by the trustee. They had been promoters of the subsidiaries of the common law trusts which were being reorganized. Their employment agreement allowed them to trade in securities of the subsidiaries. They would often acquire bonds and then sell them at a profit to the trustee, and in some instances they had purchased bonds from people who had intended to offer them to the trustee for purchase. During eight years of trusteeship Darrow filed but one account for one of the debtors. Following an SEC investigation, Darrow resigned and filed his final account which was objected to. The Supreme Court pointed out that the reorganization trustee is a representative of the court. The trusteeship, the Court said, is "serious business and is not to be undertaken lightly." The Court further said that the doing of forbidden acts calls for the sanction of personal liability. The Supreme Court further said that the responsibility could have been avoided if the questionable practice had been submitted to the court for its approval, in which case a notice would have been given to creditors and interested parties or by making reports at regular intervals (in this instance the trustee failed to report). Thus, this case shows the general ground rules.

Other decisions illustrate instances in which the trustee has been surcharged. Thus, the trustee was surcharged where he failed to pay a priority claim for

wages and at the same time exhausted the estate in paying general creditors. In re B. A. Montgomery & Son, 17 F.2d 404 (N.D. Ohio 1927).[3]

It has been held that the trustee as an officer of the court is responsible for wrongful conduct and is accountable to the court. Chappel v. First Trust Co. of Appleton, Wisconsin, 30 F. Supp. 765 (E.D. Wis. 1940).[4]

Generally, the standard is the exercise of due care, diligence and skill both as to affirmative and negative conduct. Where the trustee is negligent or willful and fails to meet the standard of care required of him, he is liable for loss. The standard or measure of care, diligence and skill is that of an ordinarily prudent man in the conduct of his private affairs under similar circumstances and with a similar object in view. It is not necessary to a surcharge of a trustee's accounts that he shall have been guilty of fraud or intentional wrongdoing. It is sufficient that the trustee has failed to discharge a duty required by the law. *See*

---

[3]In that case the court said:

> It has been repeatedly held that trustees in bankruptcy, like executors and administrators, are bound to exercise due diligence, and that, if loss or damage results from failure so to do, their reports and accounts may be surcharged. (p. 406)

[4]The court in that case said:

> A trustee in bankruptcy is an officer of the court which appoints him. If his conduct is wrongful as to the assets belonging to the bankrupt estate, he is accountable to the bankruptcy court. . . . His accounts may be surcharged for any loss that his wrongful conduct may have occasioned. (p. 766)

76 Am. Jur. 2d Trusts §§ 325, 326 and 510.[5]

No two cases in this area are alike on their facts, but there exists a similarity between this case and Mosser v. Darrow, *supra*. There the trustee failed over a period of time to file reports. At bar there was a failure to check on the malfeasance of the bookkeeper-secretary. The result in *Mosser* was that the employees made profits from trading in securities and were guilty of a conflict of interest. This, of course, was done with the knowledge of the trustee, but as we view it liability is not to be avoided by the expedient of not examining the records. The trustee was under a duty to the court and to the beneficiaries and creditors to ascertain the facts. As we view it, he could not discharge his duty of reasonable care by allowing the bookkeeper to have a free hand over a long period of time.

---

[5]Collier on Bankruptcy, Vol. 3A, § 62.03, outlines the standard applicable to a trustee in bankruptcy:

> [Trustees in bankruptcy] have a certain margin of discretion, and the courts will, in the interest of efficient administration, not fail to respect it. But whenever it comes to spending large sums money or incurring debts for the purposes of administration, the trustee or receiver should bear in mind the final act of his tenure: the verified account to the court as provided in § 62a. True, by acting in his official capacity the trustee does not incur a personal liability as does the trustee of an express trust. . . . The bankruptcy trustee acts as the representative of a separate entity, the estate; he obligates this entity . . . . [T]he General orders and § 62a constitute but a statutory application of a thoroughly recognized and time-honored mode of enforcing the court's supreme authority: the right to *surcharge* the accountable officer wherever the court finds that he misused his discretion . . . . This power to surcharge is the very essence of § 62a. It is this power that puts teeth and practical significance into an otherwise formal provision. (pp. 1406-09)

II.

In our opinion the trial court erred in holding that the successor trustee and the creditors and beneficiaries were barred by the doctrine of judicial estoppel or collateral estoppel in claiming that Clark was negligent. It is true that Clark's alleged negligence was an issue in the state case against the Exchange National Bank. However, the negligence of Clark was not directly involved. The court instructed the jury that recovery could be had if the bank knew or should have known that deposits of items made out to the trust were placed in the personal account of Billingsley. Examination of the instructions fails to reveal that the jury was told that it could only find for the plaintiff if the fraud could not have been discovered with reasonable diligence.

Under the doctrine of judicial estoppel a party and his privies who have knowingly and deliberately assumed a particular position are estopped from assuming an inconsistent position to the prejudice of the adverse party. This rule ordinarily applies to inconsistent positions assumed in the course of the same judicial proceeding or in subsequent proceedings involving identical parties and questions. *See* 31 C.J.S. Estoppel §§ 117, 118 and 119.

We are of the opinion that the subject matter in the bank case and the present case are essentially dissimilar. The relationships between the beneficiaries and creditors and the trustee are wholly different from the relationship between the trustee and the Exchange National Bank. Assuming that the trustee

was not guilty of contributory negligence in relationship to the bank, this fails to establish that the trustee was free of negligence in relationship to the beneficiaries and creditors for the simple reason that the relationship between the trustee and the bank is an arm's length one and this affects the standard of care owed. Moreover, the bank is in a far superior position to discover the wrongdoing. Its conduct could well have been classified as wanton. In the case at bar, however, the obligation to detect misconduct and wrongdoing was on Clark, and in this instance he was in a position to discover it so as to prevent injury to the trust. The beneficiaries and creditors are no more barred by the judgment in the Oklahoma suit than the district court would be barred from surcharing the trustee.

We have examined the cases submitted by Clark. In Magnolia Petroleum Co. v. Ouart, 200 Okl. 258, 192 P.2d 698 (1947), Magnolia was held to be estopped from maintaining an inconsistent position in a second suit between the same parties. In one case Magnolia had taken the position that there was a lease, whereas in the second case they took the position that there was not a lease. The Ouarts had changed their position in the first case in reliance on Magnolia's claim that a valid lease existed.

The doctrine of collateral estoppel requires that an essential element of one claim has been litigated previously and determined by a valid judgment. *See* Restatement of Judgments § 68 (1942). Here again the issues must be the same just as with judicial es-

toppel and the parties must be the same. Assuming that the parties were the same, it cannot be said that the identical issue was litigated and determined here.

The reliance on Anco Mfg. & Supply Co. v. Swank, 524 P.2d 7 (Okl. 1974) and Lewis v. Aubrey, 404 P.2d 1005 (Okl. 1965) is not correctly taken. In *Anco* the plaintiff attempted to maintain a position directly contrary to that taken by her in a former case against a different defendant. In *Lewis*, there was substantial identity of parties and the plaintiffs attempted to relitigate an issue already determined in a prior case.

Appellants contend that collateral estoppel cannot apply because of the different roles of the trustee in the two cases. In the case against the Exchange National Bank, Clark appeared in his representative capacity. Here he is defending a personal surcharge and is thus giving an account of his stewardship. *See* Hartford National Bank & Trust Co. v. Malcolm-Smith, 129 Conn. 67, 26 A.2d 234 (1942) and Restatement of Judgments § 80(a), § 85, comment (n).

It seems clear to us that the different roles which Clark was occupying in the two suits preclude him from utilizing either collateral or judicial estoppel against the creditors and beneficiaries. Also, Clark has made no showing that he was harmed and there was no way for the beneficiaries to protect themselves against this present assertion since they did not make any decisions. Indeed they consistently maintained throughout the arrangement proceeding that Clark had violated his duties to the trust. The judgment in the state court did not prejudice Clark. Rather, it

helped his position by reducing the amount of his liability. Secondly, the issues in the two actions are not, as we have indicated, the same because as we have pointed out before the relationship was different. For example, the failure of Clark to bond Billingsley was not and could not have been presented in the bank case, but above all, as we have indicated previously, the duty toward the beneficiaries of a trust is different than toward a third party and the trustee may not delegate to others duties which he is personally responsible for. *See* Restatement of Trusts 2d § 171 (1959). This issue of improper delegation was not present in the state case and this arises, of course, from the existence of the fiduciary relationship and the duties incident thereto.

We are mindful that the district court did not find that the trustee was not negligent in failing to require Billingsley to be bonded or in allowing him to handle all the financial matters of the trust.[6] There was at least some evidence that Clark had notice in 1965 that all might not be "A-1" in Billingsley's handling of the trust.[7] The trial court did not, however,

[6]Billingsley collected the mail, and thus had exclusive knowledge of what checks came in. He kept the books, made out the checks, reconciled the bank statements, prepared the monthly reports. The trust hired a firm of accountants to prepare their tax returns, but these accountants merely took the figures as shown by Billingsley. Not even the most minimal precautions were taken to prevent Billingsley from doing what he did.

[7]In 1965 or 1966, Otey Johnson, the son of Roy Johnson and a residuary beneficiary of the trust, told Clark about a problem he had with Billingsley. Johnson had owed Billingsley money, but Billingsley, instead of waiting to be paid, had simply taken money representing excess payments of a note on property in Billingsley's name but belonging to the Ardmore Hospital. Billingsley was removed from the board of the hospital because of the incident.

come to grips with this issue. It merely found that a prudent person would not have discovered Billingsley's embezzlement, but there was no fiinding that the trustee acted properly in allowing Billingsley to have a free hand in the operation of a trust that Clark was obligated to perform. We see no evidence to support the court's conclusion that a prudent person would not have discovered Billingsley's embezzlement. The answer is that a prudent person having the duties that Clark had in respect to this trust should have discovered it and so also he should have been surcharged.

It was held also that certain other expenditures for telephone and gifts, although perhaps not proper, were de minimis. With respect to this, the court appeared to place the burden of proving the impropriety of the expenditures on the appellants, but the burden was on the trustee to justify his account and to show the propriety of his expenditure. Davis v. Jones, 254 F.2d 696 (10th Cir.), *cert. denied*, 358 U.S. 865 (1958); Chisholm v. House, 183 F.2d 698 (10th Cir. 1950). While it is true that Clark may have acted properly in hiring a bookkeeper and secretary, that does not necessarily justify the amount of salaries paid or the health insurance premiums paid. Clark was not engaged in merely running a business, he was a court-appointed trustee and thus was subject to court supervision. The telephone costs in question amounted to over $11,000 from August 1, 1958 to February 28, 1971. Clark used the telephone for his own businesses although they were not listed. An accountant testified that some part of the base rate ought not to have been paid by the trust but, rather, by Clark person-

ally. If the chargeable base rates were, for example, $10 per month, the amount recoverable would have been $1,200. This is not de minimis. Clark also spent more than $400 for publications which were used for reading material for people who came into the office. These were not scrutinized in detail by the court and had they been it is doubtful that they would have been treated as de minimis.

III.

Was the trial court correct in holding that appellants had either ratified or acquiesced in the operation of the trust or were barred by laches from challenging the reasonableness of the administrative expenses?

The demand for disapproval of Clark's submission of accounts and for surcharge was filed on January 21, 1971. There is no evidence of either words or conduct constituting an express ratification of the operation. The trustee relies on the decision of the District Court for the District of Massachusetts in In re Cook, 28 F.2d 521 (D. Mass. 1928), where the referee had ordered appraisal of certain real estate and had thereafter fixed the compensation of the appraisers without giving notice to the creditors or the representatives of the bankrupt. The amount was paid by the trustee after the referee had declared a 100% dividend and had specifically authorized the appraisers' fees. Some 10 months later, when the trustee filed his final report and account, the administrator of the bankrupt objected to the allowance of the appraisers' fees. The court held that these items were not open to objection

in view of the procedures which had been taken. Clark is apparently seeking a ruling that all of the items that were included in his annual reports are not protected, but none of the payments made for expenses incurred were specifically authorized by the court and none of the annual reports were approved by the court. Furthermore, no notice was given and no hearing was held. An additional factor is that the reports were so sketchy that they did not give effective notice.

Ratification requires knowledge. *See* Davis v. Jones, 254 F.2d 696 (10th Cir.), *cert. denied*, 358 U.S. 865 (1958); Chisholm v. House, 183 F.2d 698 (10th Cir. 1950); Earll v. Picken, 113 F.2d 150 (D.C. Cir. 1940); Restatement of Trusts 2d §§ 216-218. True, the annual report showed the totals spent in various categories such as insurance, salaries, rent, telephone, but there was no indication that the insurance money was not for trust property but for health and hospital insurance on the secretary and bookkeeper, nor did the reports show that the telephone bills included unauthorized calls and use for purposes other than the trust, nor did they reflect amounts paid to Billingsley, the bookkeeper. There can be no ratification by failure to make investigation and in effect the trial court did place the burden on the beneficiaries to investigate. Instead, the trustee has a duty to make a full disclosure. *See* Restatement of Trusts 2d § 172 and, particularly, § 173.

The position that the beneficiaries and creditors are barred by laches is equally non-meritorious because this could be true only if the beneficiary had

postponed suit for an inordinate length of time, whereby it would be inequitable to allow him to proceed. Restatement of Trusts 2d § 219(1). *See also* Chisholm v. House, *supra*, at 705. Where, as here, the beneficiary has not been aware of the trustee's misfeasance, the doctrine of laches does not come into play. *See* Chisholm v. House, *supra;* Earll v. Picken, *supra;* Restatement of Trusts 2d § 219, comment (c).

The Restatement of Trusts 2d § 219, comment (a) lists ten different standards to be considered in determining applicability of laches.[8]

The attempted surcharges involve occurrences during the entire period of the trustee's tenure. There was no reason to know that the trustee had left the entire financial administration of the estate to the bookkeeper nor did the appellants have reason to know of the impropriety of the totals spent in various categories, so we see no reason for barring appellants from pursuing their claims; the appraisal of the equities does not call for it. The preliminary final account was filed December 17, 1971, and the application for surcharge was filed January 21, 1972, so once appellants were apprised of the facts they did not delay.

In view of the circumstances of this case, then, the

[8]These include the following which are relevant here:

1) Length of time elapsed between the breach and the bringing of suit; 2) whether the beneficiary knew or had reason to know of the breach; 3) whether the beneficiary had complained of the breach; 4) the reasons for delay in suing; 5) change of position by the trustee, including loss of rights against third persons; 6) death of witnesses or parties; 7) hardship to the beneficiary; 8) hardship to the trustee.

trial court's determination that it would be unfair to charge the trustee at this late date cannot be sustained. It is not shown that any changes have occurred due to the delay, but even so a transcript of what happened exists and problems such as lost witnesses can be resolved by using the transcript as the trial court did in the case at bar. It is the beneficiaries who are suffering hardship by the trial court's decree because they are prevented from recovering money which should not have been paid in the first place. On balance, then, the equities are overwhelmingly on the side of the appellants and, therefore, laches cannot operate.

IV.

A. *Lawyers Fees, Costs and Expenses.*

We finally consider whether the trial court was correct in allowing attorneys' fees in the proceedings of Clark against Billingsley in the amount of $6,000 (incurred after the defalcations came to light) and, secondly, allowing $24,000 for services in the state court proceedings against Exchange National, and $1,517.42 for costs and expenses in the two proceedings.

In contending that the court erred in charging the trust with these expenses, appellants maintain that inasmuch as these outlays were necessitated by the negligence of the trustee Clark, that the trust should not have to bear this expense; that it should be charged to Clark. They cite a comment in 90 C.J.S. Trusts § 276, which generally supports their thesis.

The action of Clark was not merely a matter of error in judgment. If it were he could not be held responsible. *Cf.* Crews v. Willis, 195 Okl. 475, 159 P.2d 251 (1945). It is true that the trust should defer such charges of an attorney who is working on behalf of the estate. *See* In re Kenin's Trust Estate, 343 Pa. 549, 23 A.2d 837 (1942); 90 C.J.S. Trusts § 284, p. 401. This does not, however, say that the trustee should not be required to *indemnify* the trust estate where he is ultimately responsible to the trust.

The court took the same view as to expenses incident to the surcharge and final account hearing. The rule with respect to this is that a trustee who unsuccessfully defends charges of maladministration resulting in a surcharge is not entitled to be paid for his costs from the trust estate and may be required to pay the costs of the beneficiaries. *See* Crutcher v. Joyce, 146 F.2d 518 (10th Cir. 1945); 76 Am. Jur. 2d Trusts § 533; 90 C.J.S. § 284, pp. 409-410. It would now be less objectionable if the trial court had recognized that the negligence of Clark was the cause of the trust's being saddled with these expenses. On remand, therefore, the matter should be reviewed and reconsidered in light of the view that this court takes of the law of the case.

B. *Trustee's Compensation.*

The trial court allowed trustee Clark 15% of the residue of the corpus of the estate after all creditors were paid. Appellants had demanded that the court compel Clark to forfeit this additional compensation

which was provided in the arrangement. This compensation was in addition to the $500 per month paid to Clark throughout the administration of the trust. The arrangement contains no provision for reduction of the 15% interest on termination of the trust. The award of this compensation was at least consistent with the trial court's viewpoint that no surcharge was called for. The matter takes on a different flavor when the opposite result is reached on surcharge.

Whether a trustee who has committed a breach of trust is to be denied compensation in whole or in part is discretionary with the court. Restatement of Trusts 2d § 243, comment (a). Thus, the Bankruptcy Court is empowered to avoid paying the trustee more than his performance requires. Restatement, *supra*, § 243, comment (a). The trial court admitted that the operation of the trust was not "ideal." This matter must also be reconsidered by the trial court in the light of this court's determination that surcharge of the trustee was necessary.

Finally, we view this as a clear case of misfeasance on the part of the trustee, since the evidence establishing it, although circumstantial, is strong. We are not here dealing with an isolated criminal incident by the bookkeeper but, rather, a repeated and continuous faithlessness and criminality over a long period of time. The trustee whose inactivity allowed this to happen cannot consistent with his fiduciary obligations be heard to say that he did not anticipate the misconduct or that the beneficiaries were themselves

at fault for not having discovered the wrongdoing and called it to his attention.

Accordingly, the cause is remanded with directions to the trial court to vacate its judgment in whole and render a new judgment surcharging the trustee for the losses suffered as a direct result of the misconduct of Billingsley. The court is directed to reconsider the attorney's fees and costs and expense items as well as the extra compensation items in the light of this court's decision, and enter appropriate judgments consistent with the views expressed herein.

APPENDIX B

Order and Opinion of the United States Court of Appeals for the Tenth Circuit denying rehearing and rehearing en banc.

MAY TERM — JUNE 19, 1975

Before The Honorable David T. Lewis, Chief Judge, The Honorable Jean S. Breitenstein, The Honorable Delmas C. Hill, The Honorable Oliver Seth, The Honorable William J. Holloway, Jr., The Honorable Robert H. McWilliams, The Honorable James E. Barrett and The Honorable William E. Doyle, Circuit Judges

No. 74-1373

IN THE MATTER OF ROY M. JOHNSON, Debtor, OTEY JOHNSON, individually and as Trustee, JOHN A. BUNN, ED GALT, OKLAHOMA BOOK AND BIBLE HOUSE, C. W. MARSH, OKLAHOMA CONFERENCE CORP. OF SEVENTH DAY ADVENTISTS AND ARDMORE HOSPITAL,

Appellants,

vs.

GORDON D. CLARK,

Appellee.

No. 74-1374

THE FIRST NATIONAL BANK AND TRUST COMPANY OF MUSKOGEE (Trustee in Succession of the Roy M. Johnson Trust),

Appellant,

vs.

GORDON D. CLARK,

Appellee.

This matter comes on for consideration of the Petition for Rehearing and Suggestion for Rehearing En Banc filed by the appellee in the captioned cases.

Upon consideration whereof, the Petition for Rehearing is denied by Circuit Judges Lewis, Breitenstein and Doyle to whom the cases were submitted.

The panel having considered the Petition for Rehearing and having denied it nevertheless wishes to make it clear that it was not the purpose of the Court in its opinion to dictate the trial court's decision with respect to the award of attorneys fees or the allowance of costs and expenses, since these matters are within the discretion of that court.

The Petition for Rehearing having been denied by the original panel to whom the case was submitted and no member of the panel nor judge in regular active service on the Court having requested that the Court be polled on Rehearing En Banc, Rule 35, Federal Rules of Appellate Procedure, the Suggestion for Rehearing En Banc is denied.

/s/ Howard K. Phillips
HOWARD K. PHILLIPS, Clerk

APPENDIX C

Oral opinion of the United States District Court for the Eastern District of Oklahoma rendered from the bench on April 19, 1974.

IN THE UNITED STATES DISTRICT COURT
FOR THE EASTERN DISTRICT OF OKLAHOMA

No. 8330

IN THE MATTER OF ROY M. JOHNSON, Debtor.
EXCERPTS OF PROCEEDINGS

APRIL 19,1974

[2] The Court: Is there anything further, Gentlemen, before we proceed with the matter of the Final Account of Trustee Clark and the motions, or applications, for surcharge?

Very well. If not, the Court has, pursuant to your stipulations, received the matter of the Final Account and the Request for Surcharge in this case. I have read the entire evidentiary record before Judge Langley in this connection. I have read the Final Account, as submitted; and I have examined, to some extent, the Monthly Reports of the Trustee made to the Court and Annual Reports made by the Trustee to the Court and to the Creditors.

I have also carefully read all the briefs that have been filed in connection with the Final Account and in the matter of surcharge.

In any bankruptcy case, including this one, of course, it is important to start out on the premise

that this Court sits as a Court of equity and governs itself in accordance with the usual principle of equity.

With reference to the matter of surcharge, I have requested your arguments in two principle [3] classifications. One, the matter of the Billingsley defalcation; and the other, the matter of the office overhead and maintenance, or more appropriately said, the manner in which the Trustee has operated the Trust under the arrangement approved by Judge Rice. I have reached the conclusion, from all of these materials, that the Court should not impose the surcharge in this case.

I'm fully aware that this is contrary to the Order that Judge Langley entered in November of 1972, which Order he subsequently vacated. I am aware that since he vacated that Order, there [has] been additional testimony received by him; and all of the Briefs that are in the file, were filed after he vacated the Order. This is to say, that I have before me more testimony than he had. I have before me all of the law that's in the file, which he did not have. At least I'm speaking of the Briefs that start with the Trustee, present Trustee's Brief, May 10, 1973.

With reference to the request that the Court surcharge the remaining balance of the Billingsley defalcation, I find a legal bar to doing this, which is threshold to this particular aspect of the surcharge, this is, that by order of [4] this Court, the present Trustee was directed to proceed in this Billingsley Defalcation against the Exchange National Bank and Trust Company of Ardmore, Oklahoma; that in that proceeding,

squarely placed in issue was whether or not the former Trustee was guilty of neglect in the handling of the affairs of the Bankrupt Estate, particular reference to the Billingsley Defalcation. It appears without question that that particular point was squarely at issue in that case, the Pleadings in that case disclosed this; the Verdict of the Jury was returned with this point presented to it; the matter was finalized in the State Courts, with a determination which had to be made in this case as far as the Billingsley Defalcations are concerned, the former Trustee was not guilty of either an improper motive or a failure to exercise diligence or failure to exercise reasonably or that he had been guilty of such gross neglect in the matter.

The Court recognizes that it isn't necessary that a Trustee be guilty of fraud, or anything of that nature, in order to have a surcharge imposed against him but I find nothing in the record to indicate fraud or dishonesty on [5] the part of the Trustee.

It is apparent, of course, that Billingsley was dishonest but this matter has been, by Order of the Court, put in issue in another case in which the current Trustee was successful; and under the cases, it's my finding and conclusion that this precludes the Court, precludes this Trustee and those in privity with this Trustee, which includes Creditors and Residuary Beneficiaries, from now taking the position diametrically opposed and completely inconsistent with the position they took, by Order of this Court, in the Exchange National Bank Case in the State Court.

This is demonstrated, I think, very well in 31 Corpus Secumdum, Section 117, at pages 610, 611, 623 and 625. It is also the law of Oklahoma, as shown by Magnolia Petroleum Company versus Wourt at 192 P2d 698. It is also recognized in Lewis versus Aubrey at 404 P2d 1005.

While this legal principle has been given various names, such as Judicial Estoppel, Collateral Estoppel, Res Judicata, it all boils down to the basic premise that during the course of litigation, a party is not permitted to assume inconsistent and contradictory positions. This is what the [6] Trustee and those in privity with the Trustee find themselves involved with.

The statement of Law Judgment on page 389, lays out the rule that finds those in privity with the Trustee, who is their representative, when this position is taken, will not permit them to assume, in the absence of the Trustee, an inconsistant postion. If this were so, this salutary rule could easily be deferred and bypassed and the desired legal result, not to play fast and loose with the Court. In this instance, it would be a burden.

Moreover, I'm not satisfied under the evidence, aside from the necessary applications of this doctrine, that this defalcation, as it has been presented to me by the record here, was brought about in such a fashion that a reasonably prudent person would have detected it. This is particularly so in this case involving a large number of properties; and I especially refer

to that property which bore no income to the Estate, as the income under it was being sent elsewhere to satisfy an obligation of the Estate; and when that obligation was satisfied, the checks came to the Trustee, handled exclusively [7] by Billingsley and diverted by him. This transaction was tailor-made for Billingsley, with his tendency for dishonesty, in as much as there had been no income from this particular property, wasn't set up in the books. The record reflects that all there was in the Estate was filed in the office, which among the numerous files didn't present any kind of a notice. And he simply realized that this was new income, as he probably found out when he diverted all of its money, and I do not feel that any Trustee could have detected this type of dishonesty.

Now, those checks that were raised are not quite as pronounced as in, perhaps, some of the other; but taking the whole transaction, the role of Billingsley before, during the Trust, I simply do not feel that, in equity, the Trustee should be surcharged in this respect.

Backing up my judgment in this regard is the determination, on this very same point, by a jury of twelve people in the Exchange National Bank Case. They had this matter before them. I understand, from the record here, how they would have reached that conclusion.

With reference to the other items sought [8] for surcharges, principally the overhead items in management trust, while this is not a good picture of how

a trust should be operated in this respect, I don't think the picture reaches the point or that the evidence is of such quality as I, in equity, can conclude such improper management and expenditure as would warrant the surcharge of these items, or any part of them, from the Trustee.

It is understandable that this arrangement, when put in force and effect, was intended by all to be of long duration. The operation, as it started out with its expenditures, seemed to fit the effort at that time without too much concern. Most everybody seems to agree that during the early years of the Trust, when the house was being put in order and properties were being operated, that the expenditures were reasonable and proper. They only give the appearance of unreasonableness when the operating properties were removed from the operation of the Trust and the Trust settled down to receiving royalty checks, lease bonuses, disposing of certain property and taking care of routine accounting, Tax Returns, and those things that go along with an operation with an income of between $30, or $40,000 a year, 30 or 40 properties.

[9] It seems to me, under the Oklahoma Trust Act and the Bankruptcy Act and the term of the arrangement itself, the powers of the Trustee were such that he had, apparently clear, the power and authority to engage a bookkeeper and secretary, he being a geologist. This was the way the trust operated before and no one, for a long period of time, saw fit to raise any question about it.

In fact, in the record here, the first time anybody

questioned this method of operation was when the Trustee sought to liquidate the matter.

As I said, this is a court of equity and the Court should do equity among all the parties. I must be mindful of the fact that this operation was clearly disclosed to all concerned on an annual basis for seven or eight years, if not more, no one raising any complaint or making any objection about it, this includes the Court as well. This could well, and probably does and I will conclude that it does, bring into play the doctrine of ratification. There is ample notice, acquiescence, passage of time; it would seem to me that this doctrine would support the result of that reasoning.

Also, the doctrine of laches is involved here. [10] If there had been any feeling of impropriety about the method of which the Trust was being operated by the Trustee, those given full notice thereof, having an interest in the matter, are not entitled to sleep on their rights and let the matter pursue its merry way until something occurs that they don't like then, at a late hour, enter a protest. This is not fair to the Trustee, even if his operation was not an ideal type operation.

It's my further judgement in the matter that, as I've indicated, this Trust is not an ideal operation, one to look at, it's easy for me to do, not being involved. But I can't say that the problem here, or the fault here if it may be termed that, can be placed on any one person. It can't be placed singularly on the Trustee. I think others were involved to such an ex-

tent that their failure to complain through the years amounts to acquiescence of ratification; whereas, the application of laches under these documents, the Court does not feel that the Trustee should be surcharged.

The Trustee, in some of his Briefs, I think, and this is supported by some of the testimony, would indicate some serious impropriety with [11] reference to the matter of the telephone and some other activities such as janitor, presents and things of this kind. Perhaps it could be said that these have been questioned but the overall picture, the Court considers these to be the minimus and not disposed to single them out. They are deemed insignificant in view of the entire picture.

Under these circumstances, the further requests that the Trustee be surcharged with certain accounting expenses, legal expenses and that he forfeit his 15 percent contingency are without merit and must be denied.

I will not undertake to make any ruling at this time on the five percent fee that, as I understand it, the Trustee is entitled to receive on a distribution of Creditors because it has not been briefed and I'm not really sure that it has been presented squarely to me but it is a reserved matter if it's necessary to be brought up at a later time.

The Court understands now, with reference to fees, that Mr. DeBois is laying no further fee claim in the matter. Is that right, Mr. DeBois?

Mr. DeBois: That's correct, [12] if the Court please.

The Court: We have a pending, and not notice to this hearing, two additional matters. One is the matter of the Accountants Claim in the amount of $1,576.21 for accounting services required during the Court Hearing before Judge Langley on August 9th, 10th and 11th, 1971. I gather, from the record, that time of these accountants was brought into the case on that occasion not at the direction of the Court or the then Trustee but by direction of the former Trustee. It's my belief that the law on this point is that had he been surcharged, these expenses would have been his but that since he is not surcharged, this type of expense was reasonable for him to incur; while not being surcharged, should be charges against the Estate. Unless someone has a different view about it, I would anticipate that this is what I will do.

The other matter is the extra legal services rendered by Mr. A. Carl Robinson in connection with the Motion of the Trustee and he represents the surcharge to the former Trustee. Judge Langley allowed a fee in this connection in his Order of November 21, 1972, which Order he subsequently [13] vacated in its entirety, which vacated the fee. This fee was paid, was returned to the Trustee by my Order when I discovered this condition. In this connection, it would be my view that the Trustee and his attorney should be entitled to present a new claim for the extraordinary services of the attorney for the Trustee in connection with the Motion of the Trustee, new Trustee, to sur-

charge the old Trustee. I have no reason to believe, at least at this time, to believe that this was not taken in good faith or wholly without some support as a reasonable person would view the matter.

So the Trustee and his Counsel may proceed in that fashion. I would appreciate having in such Application, an accurate information as to time spent and effort put forth in this extraordinary legal service.

Unless I'm mistaken, I believe the attorney for the Trustee has completed another year of regular service, have you not, Mr. Robinson?

Mr. Robinson: Yes, sir; that's correct.

The Court: While I've taken care today of your earlier, I believe it's taken [14] so long to take care of another one so that you may put in an application there.

Has the Trustee been paid for the last Trust Year?

Mr. Robinson: No, sir. We have the accounting prepared and ready to file, and the Order setting it for hearing for your signature is being prepared right now. It will be filed next week.

The Court: Well, I don't think you will need leave of the Court but the Court will entertain the Application of the Trustee for its Annual Fee and your Application for Annual Regular Fee and your Application for your Extraordinary Legal Services rendered in the past and will also at that time set for hearing the claim of Alexander Grant and Company filed with the Trustee in the amount of $1,576.21 as

having been filed on or about April 8, 1974.

I don't know what the procedure is as to whether anybody wishes to appeal my decisions as I now prepare the Final Account, as I now deny the pending motions and application to surcharge and Trustee and as I have entered orders here fixing these for Mr. DeBois in the Billingsley [15] Defalcation and in allowing $3,000 accounting fee in connection with the Ardmore Case.

I will ask you, Mr. DeBois, to prepare an appropriate Order or Judgment for my signature containing these decisions that I've made today. When it's filed by me, copies will be mailed to everybody. I will leave to you to find the procedure because I don't know. If it's an appealable order, if you desire to appeal it, you're certainly entitled to. If it's not an appealable order, we must await some final decision in this case.

I want to talk with those here about where we are going in this case. If this matter is appealed, I don't expect it to deter me from proceeding to handle the case as I think it ought to be handled to a conclusion.

The Trustee reported this morning $166,000 in cash and this is now been reduced by $33,000 at this time. It's down to $133,000, in round figures. The Trust is making some progress now if it's got an annual approximate income of $30,000 with an annual cost to operate of $3500. Outstanding claims appear to be $263,000, $205,000 of those claims are owned by one of the residuary beneficiaries and [16] Mr. Clark. Many of the Creditors have communicated to the

Court by letter and telegram, and otherwise, expressing a desire to get their money. They think they've waited long enough for it. This is to tell you that I think this Trust ought to be closed out under these circumstances. It's making $25,000 a year. If you close shop now, you owe $263,000, you've got $133,000 we can pay on it, leaves $130,000 out. It's still got some more expenses. If we are going to net $25,000, we're talking about five years yet unless something extraordinary happens to the assets of the Trust. With its history record here, I'm not of mind to let it continue on. This is personally the way I feel about it.

I'm really not sure what my authority is in this connection but I'm not going to attempt to tell you that I think we ought to rock along here for another five or six years with this thing even though it's now in good hands and is making some money. It paints a better picture than it did when the arrangement was approved. Still, this matter has been in this Court since 1958. This is not a good example of what a Court is supposed to do in a Chapter XII Proceeding. In fact, it's [17] embarrassing to this Court, in my opinion.

I wish to, in giving these observations and considerations, maybe that either ought to go up on my orders today, if you can and want to; or if you can't, you have to close out in order to do it, you may wish to close out and go up. If you're right and I'm wrong, it could bring further monies to the Estate if they can be collected. If not, I'm going to be giving some thought and attention as to what my authority is to close it and do so as expediently as possible.

I appreciate, Mr. Wilcoxen, your giving these views to your people; and Mr. Robinson, you discussing it with the Trustee.

I assume, Mr. DeBois, that you're in a position to bring these matters to the attention of Mr. Clark's father, since he appears to be a principal creditor now.

Now, what have I overlooked? Anything from over here?

Mr. DeBois: No, sir.

The Court: Anything that I've overlooked, Mr. Robinson, that you know of?

Mr. Robinson: I think not, Your Honor.

[18] The Court: Mr. Wilcoxen?

Mr. Wilcoxen: No, sir.

The Court: I'll be looking for your Order, or your Judgment now.

Mr. Debois: Yes, sir.

The Court: Thank you, Gentlemen. Court is in recess.

(Proceedings closed)

APPENDIX D

Judgment of the Court of the United States Court of Appeals for the Tenth Circuit entered

MAY TERM—MAY 29, 1975

Before The Honorable David T. Lewis, Chief Judge, The Honorable Jean S. Breitenstein, Senior Circuit Judge and The Honorable William E. Doyle, Circuit Judge

IN THE MATTER OF ROY M. JOHNSON, Debtor.

No. 74-1373
(BK-8330)

OTEY JOHNSON, Individually and as Trustee, JOHN A. BUNN, ED GALT, OKLAHOMA BOOK AND BIBLE HOUSE, C. W. MARSH, OKLAHOMA CONFERENCE CORP. OF SEVENTH DAY ADVENTISTS and ARDMORE HOSPITAL,

Appellants,

vs.

GORDON D. CLARK,

Appellee.

No. 74-1374
(BK-8330)

THE FIRST NATIONAL BANK AND TRUST COMPANY OF MUSKOGEE (Trustee in Succession of the Roy M. Johnson Trust),

Appellant,

vs.

GORDON D. CLARK,

Appellee.

This cause came on to be heard on the record on appeal from the United States District Court for the Eastern District of Oklahoma, and was argued by counsel.

Upon consideration whereof, it is ordered that the judgment of that court is reversed. The cause is remanded to the United States District Court for the Eastern District of Oklahoma with directions to conduct proceedings and to enter appropriate judgments in accordance with the opinion of this Court.

/s/Howard K. Phillips
HOWARD K. PHILLIPS, Clerk

APPENDIX E

Plan of Arrangement dated May 11, 1960
May 29, 1975

IN THE UNITED STATES DISTRICT COURT
FOR THE EASTERN DISTRICT OF OKLAHOMA

No. 8330

IN THE MATTER OF ROY M. JOHNSON, Debtor.

MODIFIED PROPOSAL FOR ARRANGEMENT

(Filed May 9, 1960)

To the Honorable Eugene Rice, Judge of the District Court of the United States for the Eastern District of Oklahoma.

The Debtor, ROY M. JOHNSON, respectfully States to this Court, that his original petition was filed in the captioned case August 5, 1958, and attached to said original petition was Exhibit "A" consisting of four (4) pieces of paper, denominated as "Proposal for Arrangement".

Your Debtor now proposes in lieu of and to take the place of any form of proposal made by him, the following:

(1) That under the direction and authority of this Court, your Debtor, Roy M. Johnson, and Gordon Clark, Trustee appointed by this Court, will create a trust for the use and benefit of the creditors of Roy M. Johnson. Said Trust to be known and designated as "The Roy M. Johnson Creditors Trust".

(2) That the trust which your debtor proposes to create will be on a form substantially the same as Exhibit "A" attached hereto, and made a part hereof.

(3) In the event such trust is authorized and actually created, the Debtor Roy M. Johnson and the Trustee appointed by this Court, Gordon Clark, will convey by good and sufficient conveyances unto said trust:

(a) All properties shown in the Debtor's Schedule attached to his original petition on file herein, as being owned by said Debtor, except that exempt from execution.

(b) Any and all other property which may be recovered by or on behalf of the Debtor from persons asserting an adverse interest therein, including but not limited to the property listed on Schedule "2" attached hereto, and made a part hereof.

(4) Your Debtor further states to this Court, that in his opinion, it would be to the best interest of all his creditors, that this plan be accepted and be put in force and effect.

(5) Your Petitioner requests that this Proposal for Arrangement be set for hearing at a time convenient to the Court, and that the Court designate in the order setting it for hearing, the notice to be given to the creditors of said Debtor.

DATED this the 5th day of May, 1960.

Exhibit "A"

ROY M. JOHNSON CREDITORS' TRUST

The undersigned, ROY M. JOHNSON, Debtor, in proceedings for real property arrangement No. 8330, in the United States District Court for the Eastern District of the State of Oklahoma, being in the Matter of ROY M. JOHNSON, Debtor, and GORDON CLARK, Trustee, appointed by the Court in said Matter, hereafter called "donors," on this the ..... day of ....., 1960, with the approval of the Court, do hereby establish the following Trust, upon the conditions and for the uses and purposes herein set forth.

WITNESSETH:

The donors (Roy M. Johnson, Debtor, and Gordon Clark, Trustee) have transferred all the interest of the debtor in the properties set forth in Exhibits "E" through "N", except that exempt from the execution, attached to the original proceedings filed in this matter, to GORDON CLARK, Trustee, the receipt of which is hereby acknowledged, which property is transferred and accepted in trust, subject to the mortgages and liens with which said properties are presently encumbered in their order of priority, the terms, conditions, uses and benefits of said trust being as follows, to-wit:

ARTICLE I.

1:01 *Name of the Trust.* The name of the trust created hereby shall be the "The Roy M. Johnson Creditors Trust", and in such name may sue and be sued.

1:02 *Initial Trustee.* The initial Trustee is Gordon Clark of Ardmore, Oklahoma.

1:03 *Successor Trustees.* In the event of a vacancy in the office of trustee, for any reason, a successor trustee, selected from one class of creditors of the debtor shall be appointed by the Judge of the United States District Court for the Eastern District of the State of Oklahoma.

1:04 *Power of Successor Trustee.* Any successor trustee shall have, from and after appointment or succession to office hereunder and without any assignment or other action by any person, all the title, interest, rights and powers including discretionary rights and powers, which are by the provisions of this instrument granted to and vested in the initial trustee.

1:05 Before assuming duties as trustee, the trustee shall subscribe to and file with the Court Clerk, an oath for the faithful performance of his duties, and in addition thereto, he will file with the Clerk, a bond in such amount as may be fixed by the Court for the faithful performance of his duties.

ARTICLE II.

2:01 The primary beneficiaries of this trust are of three (3) kinds or types, namely:

(1) Creditors holding liens of first priority;

(2) Creditors holding liens of second priority;

(3) Unsecured Creditors.

The secondary or residuary beneficiaries are Roy

M. Johnson and Gordon Clark or the heirs, successors, or assigns of either of them, who may die prior to the termination of the Trust.

ARTICLE III.

POWER OF TRUSTEE

3:01 *Power to Vote Stock.* To vote in person or by proxy all securities held by him and in such connection to delegate his discretionary powers.

3:02 *Retaining Assets in Kind.* To retain any assets legally acquired without liability for such retention, and to hold such part of the assets in cash as the trustee may deem advisable without any liability for failure to invest.

3:03 To execute leases on trust properties for periods extending beyond the term of the trust; to execute subleases and farmout agreements; to carve out of reserve such mineral interests as the trustee deems advisable or expedient; to execute unitization and pooling agreements; and to enter into contracts for the purpose of secondary recovery of oil, gas and hydrocarbons under leases belonging to the trust, even to the extent of selling and assigning such leases and retaining an economic interest in the production therefrom.

3:04 The trustee may, with the specific approval of the United States District Judge of the United States District Court for the Eastern District of the State of Oklahoma, borrow such funds as may be necessary to carry on the normal operations of such trust proper-

ties, and to issue debentures therefor which shall constitute first and prior liens upon the property of the trust.

3:05 In addition to the powers herein specifically enumerated, but subject to the specific provisions contained herein, the trustee shall have all the powers provided by the OKLAHOMA TRUST ACT 60 OSA 175.1 et seq. and any amendments thereto.

3:06 The Trustee shall, immediately after the creation of said Trust, and the transfer of the properties to the trust, issue to each unsecured creditor, having an approved claim, certificates of indebtedness equal in amount to the approved indebtedness of said unsecured creditors with interest thereon, from the date of the approval of said claim, at the rate of Four (4%) per cent per annum until paid, provided that said interest shall not be compounded.

ARTICLE IV.

ACCOUNTING

4:01 The trustee shall, on or before the 10th day of each month, file with the Clerk of the United States District Court of the Eastern District of the State of Oklahoma, a profit and loss statement covering the preceding calendar month.

4:02 The trustee shall, on or before the 1st day of February, of each year, file with the Clerk of the United States District Court at Muskogee, Oklahoma, a report showing the operation of said trust for the preceding calendar year. At the time of the filing

thereof, said trustee shall furnish a copy thereof to each creditor of all classes.

ARTICLE V.

PAYMENT TO CREDITORS

5:01 *Payment to Secured Creditors.* The trustee shall pay the net monthly income from the properties, upon which secured creditors have liens and mortgages, to the secured creditors in the order of their priority.

5:02 *Payment to Unsecured Creditors.* Net Income from properties, upon which there are no liens or mortgages, shall be paid quarterly to the unsecured creditors proportionately. When all the secured creditors have been paid in full, then the quarterly net income, upon which they may have had liens or mortgages, shall be paid to the unsecured creditors proportionately.

ARTICLE VI.

TERMINATION OF TRUST

6:01 Unless sooner terminated by the "Court", this trust shall terminate when all the secured and unsecured creditors have been paid in full. If this trust shall terminate when all the secured and unsecured creditors have been paid in full, then the residue of the corpus thereof, shall be distributed, Eighty Five (85%) per cent to Roy M. Johnson and Fifteen (15%) per cent to Gordon Clark.

6:02 If all the secured and unsecured creditors are not paid within ten (10) years from the date of the approval of the proposed arrangement, then the Court

may terminate this trust.

6:03 Not withstanding anything contained in Article VI to the contrary, the "Court" may terminate this trust at any time if it determines that it would be to the best interest of the creditors to do so.

6:04 If this trust be terminated prior to the time all creditors have been paid in full, the Court, upon such prior termination of said trust, shall order the properties constituting the corpus of the trust sold and the proceeds derived from the sale thereof, distributed and paid to the creditors then entitled thereto. If there be a residue over and above the amount necessary to pay all creditors, Eighty Five (85%) per cent of such residue shall be paid to Roy M. Johnson and Fifteen (15%) per cent to Gordon Clark.

ARTICLE VII.

COURT.

Not withstanding anything contained in this instrument to the contrary, it is expressly understood:

7:01 The term "Court" referred to in this instrument, is the United States District Court for the Eastern District of the State of Oklahoma.

7:02 That this instrument shall never be construed to deprive the Court or any rights, powers, privileges or jurisdiction conferred upon it by the Constitution, Statutes and Laws of the United States of America.

7:03 That the instrument shall never divest the Court of jurisdiction to exercise supervisory control over the administration of the trust estate.

7:04 The administration of this trust shall, at all times, be subject to the continuing jurisdiction of the United States District Court for the Eastern District of the State of Oklahoma.

7:05 No sale of any of the property constituting corpus of said trust shall be made until and unless approved by the Court, after such notice, if any, as the Court may require to be given.

ARTICLE VIII.

COMPENSATION OF TRUSTEE

8:01 The salary of Gordon Clark as Trustee, shall be Five Hundred ($500.00) Dollars per month, plus Five (5%) per cent of the amount distributed to the unsecured creditors annually, provided, however, that if he is removed or resigns as such trustee, the trust shall not be liable to him for any salary, or compensation for any period of time subsequent to his removal or resignation.

IN WITNESS WHEREOF, the donors have executed this trust indenture this the ..... day of ....., 1960.

.....

Roy M. Johnson, Debtor

.....

Gordon Clark, Trustee.

STATE OF OKLAHOMA)
) ss:
COUNTY OF.....)

BEFORE ME, the undersigned, a Notary Public, in

and for said County and State, on this ..... day of ....., 1960, personally appeared ROY M. JOHNSON, to me known to be the identical person who executed the within and foregoing instrument and acknowledged to me that he executed the same as his free and voluntary act and deed for the uses and purposes therein set forth.

Given under my hand and seal the day and year last above written.

.....

Notary Public

My Commission Expires: .....

STATE OF OKLAHOMA)
) ss:
COUNTY OF.....)

BEFORE ME, the undersigned, a Notary Public, in and for said County and State, on this ..... day of ....., 1960, personally appeared GORDON CLARK, to me known to be the identical person who executed the within and foregoing instrument and acknowledged to me that he executed the same as his free and voluntary act and deed for the uses and purposes therein set forth.

Given under my hand and seal the day and year last above written.

.....

Notary Public

My Commission Expires: .....

APPENDIX F

Order of the Court approving Plan of Arrangement dated May 11, 1960

IN THE UNITED STATES DISTRICT COURT
FOR THE EASTERN DISTRICT OF OKLAHOMA

No. 8330

IN THE MATTER OF ROY M. JOHNSON, Debtor.

ORDER OF THE COURT APPROVING PLAN OF ARRANGEMENT DATED MAY 11, 1960

(Filed May 11, 1960)

NOW, on this the 11th day of May, 1960, it is ordered as follows:

(1) The Modified Proposal for Arrangement, filed by the Debtor, be and the same is hereby confirmed and approved;

(2) The proposed Roy M. Johnson Creditors' Trust a copy of which is attached to such Modified Proposal for Arrangement, be and the same is hereby confirmed and approved and its execution authorized;

(3) The Debtor, Roy M. Johnson, and the Trustee Gordon Clark are authorized and directed to execute the declaration creating the ROY M. JOHNSON CREDITORS' TRUST, hereinabove referred to.

(4) That before entering upon the duties as Trustee of the Roy M. Johnson Creditors' Trust, Gordon Clark shall file in the Office of the Clerk of this

Court, a Bond in the penal sum of $25,000.00, for the faithful performance of his duties as Trustee of such trust, and shall also file in the Office of the Clerk of this Court, an Oath to faithfully perform his duties as Trustee.

(5) That when sub-section 4 of this Order has been complied with, the Debtor Roy M. Johnson, and the Trustee, Gordon Clark, shall execute sufficient conveyances, transfers, assignments, deeds and other necessary papers to vest all the interest of the Debtor in the properties described in Schedules and Exhibits attached to Debtor's original petition, filed herein, except that which may be exempt and subject to such mortgages and liens as may appear of record against said property.

(6) That when such conveyances, transfer, assignments, deeds and other necessary papers, have been executed in accordance with subdivision 5 of this Order, copies thereof shall be filed with the Clerk of this Court, and the originals of such instruments shall be filed in the proper recording offices.

DATED, this the 11th day of May, 1960.

APPENDIX G

Excerpts from instructions to the jury in the State Court case, Gordon D. Clark, Trustee, et al v. Exchange National Bank and Trust Company, Ardmore, Oklahoma, In the District Court in and for Carter County, Oklahoma, Cause No. C-70-220

IN THE DISTRICT COURT OF THE
TWENTIETH JUDICIAL DISTRICT,
ARDMORE, CARTER COUNTY, OKLAHOMA.

No. C-70-220

Gordon D. Clark, Trustee of the
Roy M. Johnson Creditors' Trust, Plaintiff

vs.

Exchange National Bank and Trust
Company, Ardmore, Oklahoma,
A National Banking Association, Defendant

Instructions of Court

(Filed Feb. 17, 1972)

[INSTRUCTION NO.] (7):

You are instructed that under the statutes of the state of Oklahoma an action such as the one here involved must be brought within two years after the right to bring it accrues. However, such an action which is one for relief on the ground of fraud, whether actual fraud or constructive fraud, the cause of action in such

case is not deemed to have accrued until the discovery of the fraud or from the time that such fraud could have been discovered by the use of reasonable diligence. Reasonable diligence means that degree of care which under all the facts and circumstances an ordinarily reasonable man would exercise in the conduct of his own affairs. *If you find from the evidence that this suit was brought within two years from the discovery of the fraud and could not by the use of reasonable diligence have been discovered prior thereto, then your judgment should be for the plaintiff in such amount as you find under the evidence and the other instructions that plaintiff has been damaged or is entitled to recover. If, however, you find that the plaintiff could have discovered by the use of reasonable diligence the fraud prior to the date it was discovered, then plaintiff would be barred from the recovery of all monies converted except those converted within two years prior to the bringing of this action on August 6, 1970,* together with interest at ten per cent from the date of conversion and a fair compensation for the time and money properly expended in pursuit of said monies.

A-VI 508

[INSTRUCTION NO.] (8):

"You are instructed that the *plaintiff trustee has the duty to exercise due diligence and reasonable care with regard to the trust monies and property and the handling of the affairs of the trust.* Due diligence means such diligence as a reasonable careful man would exercise in the conduct of his own affairs. Reasonable care means such care as an ordinarily reason-

able man would exercise in the conduct of his own business or affairs."

A-VI 509

[INSTRUCTION NO.] (9):

"You are therefore instructed that as to those items concerning which you are to decide herein, if you find from a preponderance of the evidence that the defendant bank acted with knowledge that H. L. Billingsley was improperly using trust funds for his own benefit, or that the bank did not use reasonable commercial standards in handling the deposits made by H. L. Billingsley to his own account, which said bank knew or should have known were the property of the plaintiff trustee, *and that plaintiff trustee was not negligent by failing to properly supervise the actions* of his agent, then your verdict should be for the *plaintiff as to all of such items. If, however, you should find from a preponderance of the evidence that the plaintiff trustee was negligent in failing to properly supervise the activities of his agent, H. L. Billingsley, in the handling of the property of the trust, and if you find that by his actions he led the bank to believe* that Billingsley was acting within the scope of his agency in the manner in which he deposited checks made to or owned by the bankruptcy trust, and if you further find that the bank acted without actual knowledge of the dishonest acts of Billingsley and in accordance with reasonable commercial standards, then you should find for the defendant as to all such items."

* * *

APPENDIX H

Oklahoma Trust Act, 60 O.S.A. Sec. 175.24

§ 175.24 Powers of trustees—Enumeration—Others not excluded—Bond of trustee

In the absence of contrary or limiting provisions in the trust agreement or a subsequent order or decree of a court of competent jurisdiction, the trustee of an express trust is authorized:

* * * To effect and keep in force, fire, rent, title, liability, casualty, or other insurance of any nature, in any form and in any amount.

G. Generally to execute any deed or other instrument and to do all things in relation to such trust necessary or desirable for carrying out any of the above powers or incident to the purposes of such trust.

H. Employ attorneys, accountants, agents, and brokers reasonably necessary in the administration of the trust estate; permit real estate held in trust to be occupied by a surviving spouse or minor child of the trustor and, where reasonably necessary for the maintenance of the surviving wife or minor child, invest trust funds in real property to be used for a home by such beneficiary; make any contracts pertaining to oil, gas, or other natural resources as are customary in the community where the real property held in trust is situated; in the trustee's discretion pay funeral expenses of any beneficiary actually receiving benefits from the trust estate at the time of his or her death.

I. The following rules of administration shall be

applicable to all express trusts but such rules shall not be exclusive of those otherwise imposed by law unless contrary to these rules:

* * *

3. A trustee shall have a lien and may reimburse himself with interest for, or pay or discharge out of the trust property, either principal or income or both, all advances made for the benefit or protection of the trust or its property and all expenses, losses, and liabilities, not resulting from the negligence of the trustee, incurred in or about the execution or protection of the trust or because of his holding or ownership of any property subject thereto.

* * *

J. The powers, duties, and responsibilities stated in this Act shall not be deemed to exclude other implied powers, duties, or responsibilities not inconsistent herewith.

K. Pay all taxes and assessments levied or assessed against the trust estate or the trustee by governmental taxing or assessing agencies.

* * *

SUPREME COURT, U. S.
FILED
SEP 10 1975
MICHAEL RODAK, JR., CLERK

IN THE

Supreme Court of the United States

OCTOBER TERM, 1975

No. 75-133

GORDON D. CLARK, *Petitioner*,

v.

OTEY JOHNSON, ET AL., *Respondents*.

Petition for a Writ of Certiorari to the United States Circuit Court of Appeals for the Tenth Circuit

BRIEF FOR RESPONDENTS IN OPPOSITION

MICHAEL S. YAROSCHUK
TIMOTHY J. PARSONS
918 Sixteenth Street, N.W.
Washington, D. C. 20006
Attorneys for Respondents

Of Counsel:

HAROLD E. KOHN, P. A.,
Attorneys at Law
1776 K Street, N.W.
Washington, D. C. 20006

ANDREW C. WILCOXEN
112 North Fifth Street
Muskogee, Oklahoma 74401

A. CARL ROBINSON
213 North Third Street
Muskogee, Oklahoma 74401

PRESS OF BYRON S. ADAMS PRINTING, INC., WASHINGTON, D. C.

INDEX

	Page
OPINIONS BELOW	1
JURISDICTION	1
QUESTIONS PRESENTED	2
STATUTES INVOLVED	2
STATEMENT	4
ARGUMENT	10
I. The Decision Below Is Clearly Correct	12
II. There Is No Important Question of Federal Law	15
III. There Is No Conflict With the Decisions of Other Courts	18
CONCLUSION	20
APPENDIX	A-1

CITATIONS

CASES:

Allis Chalmers Mfg. Co. v. Wichman, 220 F.2d 426 (8th Cir.), *cert. denied*, 350 U.S. 835 (1955)	13
American National Bank v. United States, 421 F.2d 442 (5th Cir. 1970)	13
Ammerman v. Miller, 488 F.2d 1285 (D.C. Cir. 1973)	13
B. A. Montgomery & Son, *In re*, 17 F.2d 404 (E.D. Ohio 1927)	16
Baum v. Continental Illinois National Bank & Trust Co., 230 F.2d 115 (7th Cir. 1956)	19
Carson, Pirie, Scott & Co. v. Turner, 61 F.2d 693 (6th Cir. 1932)	16

Page

Case v. Morrisette, 475 F.2d 1300 (D.C. Cir. 1973) ... 13
Casner v. Commissioner, 450 F.2d 379 (5th Cir. 1971) 13
Chappel v. First Trust Co., 30 F. Supp. 765 (E.D. Wis. 1940) 16
Chisholm v. House, 183 F.2d 698 (10th Cir. 1950) 17
Connelly v. Hancock, Dorr, Ryan & Shove, 195 F.2d 864 (2d Cir. 1952) 17
Crutcher v. Joyce, 146 F.2d 518 (10th Cir. 1945) 14
Darter v. Greenville Community Hotel Corp., 301 F.2d 70 (4th Cir. 1962) 13
Davis v Jones, 254 F.2d 696 (10th Cir.), *cert. denied*, 358 U.S. 865 (1958) 14, 17
Earll v. Picken, 113 F.2d 150 (D.C. Cir. 1940) 17
Epperson v. Connecticut Fire Insurance Co., 314 F.2d 486 (10th Cir. 1963) 13
F. W. Stock & Sons v. Thompson, 194 F.2d 493 (6th Cir. 1952) 12
Frazier, III v. Alabama Motor Club, Inc., 349 F.2d 456 (5th Cir. 1965) 13
Hartford National Bank & Trust Co. v. Malcolm-Smith, 129 Conn. 67, 26 A.2d 234 (1942) 19
International Union of Operating Engineers, Local 627 v. Arthurs, 480 F.2d 603 (10th Cir. 1973) 13
Johnson v. Goodyear Tire & Rubber Co., 491 F.2d 1364 (5th Cir. 1974) 13
Mississippi Valley Iron Co., *In re*, 58 F. Supp. 222 (D. Mo. 1944) 16
Mosser v. Darrow, 341 U.S. 267 (1951) 2, 15
Norman v. Young, 422 F.2d 470 (10th Cir. 1970) 12
Owen v. Chemical Union Fire Ins. Co., 211 F.2d 488 (4th Cir. 1954) 13
Tucker v. Dr. P. Phillips Co., 139 F.2d 601 (5th Cir. 1943) 17
United States v. Goldfield Corp., 384 F.2d 669 (10th Cir. 1967) 12-13
United States v. Mason, 412 U.S. 391 (1973) 16
United States v. United States Gypsum Co., 333 U.S. 364 (1948) 13
United States *ex rel.* Ackerman v. Russell, 388 F.2d 21 (3d Cir. 1968) 12
United States *ex rel.* Paxos v. Rundle, 491 F.2d 447 (3d Cir. 1974) 13-14

Page

United States *ex rel.* Willoughby v. Howard, 302 U.S. 445 (1938) 15-16
United States Fidelity & Guaranty Co. v. Bray, 225 U.S. 205 (1912) 18
United States Fidelity & Guaranty Co. v. State of Oklahoma, 383 F.2d 417 (10th Cir. 1967) 12-13
Zenith Radio Corp. v. Hazeltine Research, Inc., 395 U.S. 100 (1965) 13

STATUTES:

Bankruptcy Act, 11 U.S.C.A. §§ 75, 94, 102, 845..... 2, 3, 17, 20
Rule 52(a) Fed. R. Civ. P. 3, 4

MISCELLANEOUS:

Am. Jur. 2d Trusts § 632 19
1B Moore, Federal Practice § 0.411 at 1421-1448 (2d ed. 1953) 19
Restatement of Judgments §§ 80(a), 85, comment n .. 19
Restatement of Trusts (Second) §§ 172, 173, 216-219.14, 17
2A Scott, Trusts 1408 (3d ed. 1967) 16
9 Wright & Miller, Federal Practice and Procedure, Civil §§ 2571, 2585 14

IN THE

Supreme Court of the United States

OCTOBER TERM, 1975

No. 75-133

GORDON D. CLARK, *Petitioner,*

v.

OTEY JOHNSON, ET AL., *Respondents.*

Petition for a Writ of Certiorari to the United States Circuit Court of Appeals for the Tenth Circuit

BRIEF FOR RESPONDENTS IN OPPOSITION

OPINIONS BELOW

The opinion of the District Court was an oral opinion and has not been reported. (See Petitioner's Appendix * C, A-25 - A-37.) The opinion of the Court of Appeals for the Tenth Circuit has not yet been reported. (See Pet. App. A, A-1 - A-22.) The order and opinion denying rehearing and rehearing en banc has not been reported. (See Pet. App. B, A-23 - A-24.)

JURISDICTION

The jurisdictional requisites are adequately set forth in the Petition.

* Cited hereinafter as "Pet. App."

QUESTIONS PRESENTED

1. Whether the Court of Appeals acted correctly in its review of the order of the lower court in which the lower court denied a surcharge and approved the final account of a trustee in bankruptcy.

2. Whether the Court of Appeals correctly construed and applied the standard of care to be exercised by a trustee in bankruptcy and followed this Court's teaching in *Mosser* v. *Darrow*, 341 U.S. 267 (1951).

3. Whether the Court of Appeals acted properly in reversing the lower court and correcting the lower court's erroneous interpretation of the doctrine of collateral or judicial estoppel.

4. Whether a trustee in bankruptcy acted in accordance with the orders of the court establishing the trust, followed the requirements of the Bankruptcy Act, and exercised the proper standard of care required of an officer of the court.

5. Whether in a final accounting of a trustee in bankruptcy the burden is upon the trustee to demonstrate to beneficiaries and creditors the reasonableness of expenditures which have been challenged.

STATUTES INVOLVED

§ 75. *Trustees; duties*

(a) Trustees shall . . .; (2) deposit all money received by them in designated depositories . . .; (5) keep records and accounts showing all amounts and items of property received and from what sources, all amounts expended and for what purposes and all items of property disposed of. . . .

Bankruptcy Act, 11 U.S.C.A. 75

§ 94. *Notices*

(a) Creditors shall have at least ten days' notice by mail, . . . of . . .; (5) the filing of all accounts of the receivers and trustees for which confirmation is asked, and the time when they will be examined and passed upon. . . .

Bankruptcy Act, 11 U.S.C.A. 94

§ 102. *Expenses of administering estates; unauthorized sharing of fees; withholding allowances*

(a) (1) The actual and necessary costs and expenses incurred by officers, other than referees, in the administration of estates shall, except where other provisions are made for their payment, be reported in detail under oath, and examined and approved or disapproved by the court. If approved they shall be paid or allowed out of the estates in which they were incurred.

Bankruptcy Act, 11 U.S.C.A. 102

§ 845. *Operation of business and management of property; reports*

The trustee or the debtor in possession shall have the power, upon authorization by and subject to the control of the court, to operate the business and manage the property of the debtor during such period, limited or indefinite, as the court may from time to time fix, and during such operation or management shall file reports thereof with the court at such intervals as the court may designate.

Bankruptcy Act, 11 U.S.C.A. 845

Federal Rules of Civil Procedure

Rule 52. Findings by the Court.

(a) Effect. In all actions tried upon the facts without a jury or with an advisory jury, the court shall find the facts specially and state separately its conclusions of law thereon, and judgment shall be entered

pursuant to Rule 58; and in granting or refusing interlocutory injunctions the court shall similarly set forth the findings of fact and conclusions of law which constitute the grounds of its action. Requests for findings are not necessary for purposes of review. Findings of fact shall not be set aside unless clearly erroneous, and due regard shall be given to the opportunity of the trial court to judge of the credibility of the witnesses. The findings of a master, to the extent that the court adopts them, shall be considered as the findings of the court. If an opinion or memorandum of decision is filed, it will be sufficient if the findings of fact and conclusions of law appear therein. Findings of fact and conclusions of law are unnecessary on decisions of motions under Rules 12 or 56 or any other motion except as provided in Rule 41(b).

STATEMENT

This case deals with an action by beneficiaries and creditors seeking to surcharge a trustee in bankruptcy for deficiencies in his account. The litigation concerns the manner in which a trustee in bankruptcy, appointed by order of the court, carried out the duties and responsibilities reposed in him as a fiduciary and an officer of the court by the Bankruptcy Act and by common law. The case also raises for consideration the duties imposed upon a court in its review and approval of accounts submitted by a trustee in bankruptcy.

The respondents are constrained to restate the facts as presented by the petitioner because significant facts [1] have been omitted. On August 5, 1958, Roy Johnson filed a petition for an arrangement under Chapter XII of the Bankruptcy Act. The United States District

---

[1] The Court of Appeals in its opinion sets forth succinctly the significant operable facts. The respondents will in large measure follow this statement.

Court for the Eastern District of Oklahoma approved the proposed arrangement and confirmed the same on May 11, 1960. At that time, Petitioner Clark was appointed trustee.[2] The arrangement required the trustee to continue the business, to submit a profit and loss statement each month, to pay income from mortgaged property to secured creditors, and to pay the remaining income to the unsecured creditors. Subsequently, in 1960, Roy Johnson died. In 1961 the court ordered the trustee to submit annual *audits* to the court and creditors.[3] The annual reports which were submitted were unaudited and were prepared by accountants from figures furnished by a bookkeeper who was employed by Clark.

As soon as he was appointed trustee, Petitioner Clark had hired a bookkeeper, Billingsley,[4] and a secretary to assist in the management of the trust. The trustee did not have Billingsley bonded; yet he permitted Billingsley to handle all financial matters of the trust. Billingsley collected the mail, kept the books, made out the checks, reconciled the bank statements, and prepared monthly reports. Billingsley received all of the income of the trust and had absolute control over all expenditures. Besides being trustee, Petitioner Clark, who is a geologist, operated his own business and a

---

[2] At the time the arrangement for creditors was proposed, Petitioner Clark advised the court that he expected the matter would not take more than four and a half years to resolve. To date, the trust is still in effect. The petitioner served as trustee until March 1, 1971. At the time of its creation, the trust was intended to continue for ten years.

[3] See respondents' Appendix.

[4] Billingsley had been previously employed by Roy Johnson and was familiar with Mr. Johnson's affairs.

partnership with his father. All were conducted in the same office, and Billingsley and the secretary performed services for all three businesses.

As of November, 1962, the working interests of the trust had been sold, the secured creditors paid, and only passive royalty interests were retained by the trust. After 1962, the activities of the trustee consisted almost entirely of depositing thirty royalty checks each month in the bank, filing a monthly report and an annual report with the court, and preparing annual tax returns for the trust. Distributions to the unsecured creditors were made on July 31, 1962; August 15, 1962; September 11, 1963; and July 31, 1968. The remaining reduction of debt amounted to approximately 30 percent. During the period that Petitioner Clark served as trustee, the trust earned approximately $700,000. Of that sum, $426,095.12 were consumed by administrative expenses.

During the period that Petitioner Clark served as trustee, he filed monthly statements and annual reports, copies of which were sent to creditors. However, the reports were not detailed as to the nature and purpose of the expenses, and there was no way to tell whether the expenses were reasonable and proper. No complaints were filed by creditors. Although in 1965 or 1966 Respondent Otey Johnson, a residuary beneficiary of the trust, had alerted Clark to a problem he had had with the bookkeeper,[5] Clark took no steps to supervise the actions of Billingsley nor to keep himself informed of the operation of the trust.

In 1969 in the course of preparing the annual tax return, accountants discovered a discrepancy which led

---

[5] See Pet. App. A, A-14, note 7.

to further investigation and revelation that Billingsley had been embezzling money from the trust from its inception.[6] In sum Billingsley embezzled over $50,000 from the trust.

After discovery of the wrongdoing, Clark dismissed Billingsley, took legal steps to enjoin him from disposing of his property, and obtained a judgment against him. The trustee obtained permission from the court and instituted suit in his representative capacity to recover from the Exchange National Bank and Trust Company of Ardmore the trust funds deposited by Billingsley. In April, 1970, the trustee sought an order extending the life of the trust in order to pursue the Billingsley recovery. At the time the trustee sought the extension, he requested an order allowing liquidation of the assets and termination of the trust. The beneficiaries and some of the creditors objected to this. As a result, a hearing was held in October, 1970, in which the court directed the trustee to file a preliminary accounting. On December 17, 1970, Trustee Clark filed the requested preliminary final account. On January 21, 1971, the respondents, objecting creditors and beneficiaries, applied to the court to surcharge the trustee for the deficiencies attributable to Billingsley's embezzlement and also for alleged excessive administrative expenses. The respondents also requested that the trustee be denied the additional compensation which the plan would have given him.

---

[6] The manner of the embezzlement is not relevant. However, it is interesting to note the simplicity of some of the practices. For example, Billingsley not infrequently raised his salary checks by $1,000 by placing a 1 before the proper salary figure. He also converted royalty checks by depositing them to his own account at the Exchange National Bank of Ardmore, which also served as depository of the trust.

In February, 1971, another hearing was held to consider modification of the arrangement to continue it for another year. The trustee objected to its continuation and resigned, whereupon the court ordered Clark to file a final report and ordered that the surcharge determination be delayed. On March 1, 1971, the First National Bank and Trust Company of Muskogee was named to succeed Clark. The successor trustee also replaced Clark as the plaintiff in the suit against the Exchange National Bank. In the state court trial, the successor trustee prevailed. In the proceeding before the state court to recover Billingsley's deposits from the bank, the matter of Trustee Clark's negligence in administering the trust estate and the manner in which he carried out his fiduciary duties was not in issue. The state court proceeding dealt only with the relationship between the trustee and the depository bank and the conduct of the bank.

A hearing on Clark's final report and request for discharge was held in August, 1971. At that time testimony and evidence were presented by the parties before Judge Edward Langley. Judge Langley took the case under advisement and on November 21, 1972, entered an order surcharging Clark $157,185.99. However, on January 2, 1973, Judge Langley vacated the order of surcharge. Another hearing was held on April 24, 1973. At the court's request, briefs were submitted by the parties. Before a decision could be made, Judge Langley died. By stipulation the case was then tried on the record by Judge Daugherty, and on April 19, 1974, oral arguments were made. On May 3, 1974, Judge Daugherty entered an order denying the surcharge and approving the final account of Clark.

As stated by the Court of Appeals, the trial court ruled:

> (1) That the judgment allowing the estate to recover against the Exchange National Bank somehow barred or prevented a surcharge in these proceedings. The court's reasoning was that the creditors and beneficiaries were barred from asserting a position inconsistent with that maintained in the prior proceeding;
>
> (2) The court was uncertain as to whether a reasonably prudent person could have detected Billingsley's conversions;
>
> (3) The court refused to surcharge for excessive administrative costs on the ground that it felt unable to conclude improper management by Clark warranting surcharge;
>
> (4) The court felt that the objectors were barred because of their failure to object to the reports which were filed regularly. The ruling was that they had either ratified or acquiesced;
>
> (5) The beneficiaries and creditors were barred by laches. They had not objected and thus it would be unfair to surcharge the trustee after passage of the years involved;
>
> (6) The court held that the misuse of the telephone and the making of gifts out of trust funds was de minimis;
>
> (7) The accounting expenses and legal expenses occasioned by the substantial losses to the trust were not chargeable under the totality of the facts; finally, the crowning blow was the court's ruling that the trustee was entitled to his 15% of the residue of the estate. (Pet. App. A, A-6-A-7.)

On appeal the respondents *challenged all of these rulings.* The entire record was submitted to the Court of Appeals for review. The parties submitted briefs

which explored fully all of the issues in the case,[7] and there was full oral argument. On May 29, 1975, the Court of Appeals filed its decision in which it found that the lower court erred in its findings of fact and conclusions of law. Accordingly, the Court of Appeals remanded the case to the lower court with directions to vacate its judgment in whole and render a new judgment surcharging the trustee for the losses suffered as a direct result of the misconduct of Billingsley. The trial court was directed to reconsider the attorney's fees and costs and expense items as well as the extra compensation items in light of the appellate court's decision and enter appropriate judgments consistent with the views expressed in the court's opinion.

On June 9, 1975, Petitioner Clark filed a request for a rehearing en banc which was denied on June 19, 1975. In its order, the court stated, "The panel . . . wishes to make it clear that it was not the purpose of the Court in its opinion to dictate the trial court's decision with respect to the award of attorney's fees or the allowance of costs and expenses, since these matters are within the discretion of that court." (Pet. App. B, A-24.)

ARGUMENT

The instant case deals with the administration of a particular trust estate. It focuses on the conduct of a particular trustee in the exercise of his fiduciary duties. The case turns on its own facts, and no amount of strained semantics can convert it into one warranting review by this Court on certiorari. The decision of the

---

[7] On appeal, Petitioner Clark stated that there was but a single issue before the Court of Appeals: Were the findings of facts, conclusions of law, and judgment of the lower court in denying the surcharge of the former trustee clearly erroneous?

Court of Appeals has little if any impact on persons other than the immediate creditors and residuary beneficiaries who have been harmed by the actions of the trustee in this case.

The Court of Appeals in its review of the case found that the lower court had erred in its conclusions of law, and this error precluded the lower court from conducting the required examination of the trustee's conduct. The trustee had been charged with specific acts of negligence in the exercise of his fiduciary duties. The trustee was asked to justify and set forth the basis for administration expenses deemed excessive by the creditors and residuary beneficiaries. The lower court was requested to surcharge the trustee because he had breached his duties as a fiduciary and a trustee appointed by the court. Nonetheless, the lower court failed to conduct the detailed examination required by the law because it felt itself somehow precluded by a prior state court decision and because it felt that in its interpretation of the law, the creditors and residuary beneficiaries were barred by laches and ratification.

The Court of Appeals after review of the record concluded that not only had the lower court erred in its conclusions of law but no evidence could be found to support critical factual conclusions. A key element in the case was the fact that the trustee in bankruptcy had turned over for all practical purposes the management of the trust to an embezzling bookkeeper. The trustee took no action to bond this person; he took no steps to supervise him. The lower court made no findings as to whether such conduct constituted negligence. Instead, the lower court concluded that a prudent person would not have discovered the bookkeeper's embezzlement. After review of the record, the court concluded that

this finding was totally without evidentiary support—in short, clearly erroneous. (Pet. App. A, A-15.)

The decision of the Court of Appeals reflects no departure from established principles of law articulated by this Court. It presents no novel interpretation of the law nor any important question of federal law. At best, the decision sets forth in careful, well-reasoned and concise terms the standard of care expected of a trustee in bankruptcy. As the court made clear, a trusteeship is "serious business and is not to be undertaken lightly." (Pet. App. A, A-8.)

I.

The Decision Below Is Clearly Correct

Petitioner asserts that the Court of Appeals so departed from the usual and accepted review procedures as to constitute plain and simple error. (Petition, pp. 15-18.) This is incorrect. The Court of Appeals observed faithfully the requirements of Rule 52(a) of the Federal Rules of Civil Procedure. The rule in the tenth circuit, as in other circuits, is that the findings of the lower court sitting without a jury will not be disturbed unless they are clearly erroneous.[8] *Norman* v. *Young*, 422 F.2d 470 (10th Cir. 1970); *United States* v. *Gold-*

---

[8] In this case, considerable testimony was presented before Judge Langley, who died before he could render a decision. The case was later tried by Judge Daugherty on the record without the opportunity to assess the credibility and demeanor of the witnesses. Even though the parties stipulated to a trial on the record, the credibility of the witnesses was an implicit factor for consideration. In such a case, the findings of the court do not have the same binding effect. F. W. Stock & Sons v. Thompson, 194 F.2d 493 (6th Cir. 1952); see also, United States *ex rel.* Ackerman v. Russell, 388 F.2d 21 (3d Cir. 1968); United States Fidelity

field Corp., 384 F.2d 669 (10th Cir. 1967); *Epperson* v. *Connecticut Fire Insurance Co.*, 314 F.2d 486 (10th Cir. 1963). Nonetheless, a finding is "clearly erroneous" when, after review of the entire record, the reviewing court is left with the definite and firm conviction that a mistake has been committed. *Zenith Radio Corp.* v. *Hazeltine Research, Inc.*, 395 U.S. 100 (1965); *United States* v. *U.S. Gypsum Co.*, 333 U.S. 364 (1948); see also, *Casner* v. *Commissioner*, 450 F.2d 379 (5th Cir. 1971). Further, the "clearly erroneous" rule does not apply if the trial court has committed an error of law which has manifestly influenced or controlled its findings of fact, *Ammerman* v. *Miller*, 488 F.2d 1285 (D.C. Cir. 1973); *Case* v. *Morrisette*, 475 F.2d 1300 (D.C. Cir. 1973); *Darter* v. *Greenville Community Hotel Corp.*, 301 F.2d 70 (4th Cir. 1962); *Allis Chalmers Mfg. Co.* v. *Wichman*, 220 F.2d 426 (8th Cir.), *cert. denied*, 350 U.S. 835 (1955); *Owen* v. *Commercial Union Fire Ins. Co.*, 211 F.2d 488 (4th Cir. 1954), or has applied an improper legal standard, *Johnson* v. *Goodyear Tire & Rubber Co.*, 491 F.2d 1364, 1372 (5th Cir. 1974); *International Union of Operating Engineers, Local 627* v. *Arthurs*, 480 F.2d 603 (10th Cir. 1973); or if the finding is unsupported by the evidence in the record. *Case* v. *Morrisette, supra; United States ex rel. Paxos* v. *Run-*

& Guaranty Co. v. State of Oklahoma, 383 F.2d 417 (10th Cir. 1967). Moreover, where certain facts are undisputed, as in this case, and there is no issue of credibility and the Court of Appeals is called upon to apply reason and interpretation, the "clearly erroneous" rule has been held to yield. It has been held that the appellate court is in as good a position as the trial court to evaluate the testimony and evidence. Frazier, III v. Alabama Motor Club, Inc., 349 F.2d 456, 458 (5th Cir. 1965); see also, American National Bank v. United States, 421 F.2d 422, 451 (5th Cir. 1970).

dle, 491 F.2d 447 (3d Cir. 1974); see generally, 9 WRIGHT & MILLER, FEDERAL PRACTICE AND PROCEDURE, Civil §§ 2571, 2585. Under these established principles, the Court of Appeals rendered its decision. It determined that the lower court had erred in its conclusions of law in several regards: (1) in holding that the successor trustee and the creditors and beneficiaries were barred by the doctrine of judicial or collateral estoppel in claiming Clark was negligent [9] (Pet. App. A, A-11); (2) in applying the doctrines of laches and ratification to claims of the beneficiaries and creditors [10] (Pet. App. A, A 17 - A-19); and (3) in charging the trust with expenses necessitated by the negligence of the trustee[11] (Pet. App. A, A-19 - A-20). In its overall view of the record, there can be little doubt that the Court of Appeals was left with the firm and abiding conviction that a mistake had been committed.[12] In the view of the appellate court, this was a clear case of misfeasance. It is the beneficiaries, those who were to be protected by the fiduciary, who as a consequence of the lower court's decision have been made to suffer the hardship. As the Court of Appeals stated in its review of the evidence,

---

[9] This point will be covered in greater detail in respondents' succeeding argument *infra,* pp. 18-20.

[10] See RESTATEMENT OF TRUSTS (Second) §§ 172, 173, 216-219; see also, Davis v. Jones, 254 F.2d 696 (10th Cir.), *cert. denied,* 358 U.S. 865 (1958).

[11] Crutcher v. Joyce, 146 F.2d 518 (10th Cir. 1945).

[12] After reviewing all the record evidence, the appellate court was convinced that the trustee had mismanaged the estate and was constrained to state, "[F]inally the crowning blow was the court's ruling that the trustee was entitled to his 15% of the residue of the estate." (Pet. App. A, A-7.) This would have been compensation in addition to the $500 per month already paid for administering a relatively passive trust.

"the equities in the case are overwhelmingly on the side of the appellants." (Pet. App. A, A-19.)

II.

There Is No Important Question of Federal Law

The petitioner contends that the Court of Appeals has misapplied this Court's decision in *Mosser* v. *Darrow*, 341 U.S. 267 (1951), and established a new standard of care for fiduciaries (Petition, pp. 19-24, 29-33). The petitioner strains credulity and semantics to create an argument out of whole cloth. The Court of Appeals in its decision has simply articulated and applied the standard of care and diligence established for fiduciaries and trustees in bankruptcy.

The appellate court's reliance on *Mosser* served simply as a touchstone to emphasize the fact that "a trusteeship is a serious business and not to be undertaken lightly or so discharged. The most effective sanction for good administration is personal liability for the consequences of forbidden acts." 341 U.S. 271.[13] The Court of Appeals stated and applied to the facts before it principles of law in accord with the decisions of this Court. There can be little doubt from a reading of the Court of Appeals decision that the court expected the trustee to have exercised such care and skill as a man of ordinary prudence would exercise in dealing with his own property.

> By the common law every trustee or receiver of an estate has the duty of exercising reasonable care in the custody of the fiduciary estate unless relieved

---

[13] The appellate court itself recognized that the cases were not alike on their facts. However, the duty of reasonable care was the same. (Pet. App. A, A-10.)

of such duty by statute or order of court. *United States ex rel. Willoughby* v. *Howard,* 302 U.S. 445, 450 (1938).

United States v. *Mason,*[14] 412 U.S. 391 (1973); see also, 2A SCOTT, TRUSTS 1408 (3d ed. 1967). It is well settled that if trust property is lost or destroyed or diminished, the trustee is subject to surcharge if he has failed to exercise the required care and skill. 412 U.S. at 398; *Chappel* v. *First Trust Co.,* 30 F. Supp. 765 (E.D. Wis. 1940); *Carson, Pirie, Scott & Co.* v. *Turner,* 61 F.2d 693 (6th Cir. 1932); *In re B. A. Montgomery & Son,* 17 F.2d 404 (E.D. Ohio 1927).

The Court of Appeals articulated no new standards nor departed from established principles. The decision properly corrected the trial court's erroneous application of the law with regard to (1) collateral or judicial estoppel, (2) the doctrines of laches and ratification, and (3) the duty of the lower court in approving the final account.

The law is well established that the trustee in bankruptcy is an officer of the court subject at all times to the orders of the court in the administration of the bankrupt's assets.[15] *In re Mississippi Valley Iron Co.,* 58 F. Supp. 222 (D. Mo. 1944). The district court in the case at bar did not scrutinize the actions of the trustee in light of the specific charges which were raised by the respondents, residuary beneficiaries and creditors. Clearly, the trustee in this case delegated

---

[14] The petitioner has cited this case in support for its argument that the appellate court has misapplied this Court's opinion in Mosser. Yet it is clear that the appellate court is applying the same standard of care.

[15] The trustee did not follow the 1961 order of the court which directed the filing of annual audits.

the duties of his office to an embezzling subordinate. The law is clear that there can be no such delegation. *Connelly* v. *Hancock, Dorr, Ryan & Shove,* 195 F.2d 864 (2d Cir. 1952).

The trial court under its mistaken view of the law did not impose upon the trustee the duty of accounting in detail the nature and purpose of the challenged administrative expenses. See Bankruptcy Act (11 U.S.C.A. §§ 75, 102). The law in this regard is clear. When seeking approval and confirmation of his report, the burden is upon the trustee to show the nature of each challenged transaction, to show that the trust was administered in accordance with the trust instrument, and to show that the trustee acted honestly and with fidelity to the trust reposed in him. *Davis* v. *Jones, supra* note 10; *Chisholm* v. *House,* 183 F.2d 698 (10th Cir. 1950); *Earll* v. *Picken,* 113 F.2d 150 (D.C. Cir. 1940). Because the facts with regard to the expenditures of the trust are peculiarly within his knowledge, the burden to justify the expenditures is on the trustee, not upon the beneficiaries. *Tucker* v. *Dr. P. Phillips Co.,* 139 F.2d 601 (5th Cir. 1943); see also, RESTATEMENT OF TRUSTS (SECOND) §§ 172, 173.

In the facts of this case, the appellate court found that the trial court misapplied the doctrines of laches and ratification to work an unconscionable hardship on those whom the trust was intended to protect. (Pet. App. A, A-16 - A-19.) The respondents acted in timely fashion, in accord with the provisions of the Bankruptcy Act, to challenge the petitioner's final account. 11 U.S.C.A. § 94(a). Prior to the filing of the preliminary report and the final report, the court held no hearings nor did it approve the unaudited reports which had

been filed by the trustee.[16] No opportunity was afforded to challenge the trustee's account. As soon as the trustee presented his account, the respondents moved to challenge. As is evident from the foregoing, there is no important question of federal law presented.

III.

There Is No Conflict with the Decisions of Other Courts

The jurisdiction of the court in bankruptcy is exclusive. *United States Fidelity & Guaranty Co.* v. *Bray,* 225 U.S. 205 (1912). It was the duty of the bankruptcy court in this case to determine whether Trustee Clark discharged his duties and responsibilities as a fiduciary and representative of the court in a proper manner. The trial court did not perform its required duty. Instead, the trial court determined that the creditors and beneficiaries were barred by the doctrine of collateral or judicial estoppel as a consequence of a prior state court proceeding involving a suit by the trustee in his representative capacity to recover funds embezzled from the trust under his charge.[17] The appellate court determined that the lower court was in error in this matter and in its analysis of the case law. (Pet. App. A, A-11 - A-14.) The decision of the Court of Appeals in this regard is not in conflict with any

---

[16] By order of the court in 1961, the trustee was directed to file annual audited reports. This was not done. The reports that were filed were unaudited and were based upon the figures furnished to accountants by the embezzling bookkeeper, Billingsley. The reports were general in nature and could not have furnished the court with information as to the reasonableness of the charges or the nature and purpose of such expenditures. (Pet. App. A, A-2, A-4, A-15-A-17.)

[17] The embezzlement would not have taken place but for the trustee's negligence.

decisions of this Court, the federal courts, nor any state court. Analysis of the cases cited by the petitioner discloses no such conflict. The Court of Appeals decision is a correct statement of the law. In order for the doctrine of collateral or judicial estoppel to apply, there must be identity or privity of parties and identity of the subject matter or issues. Neither requirement is satisfied in this case.

The suit in the state court involved the trustee *in his representative capacity.* The instant proceeding involves an action against the trustee *in his individual capacity.* It is well settled that when a person appears in two suits in different capacities, a judgment rendered in one suit has no conclusive force in the other, if the person is a party to one suit solely as an individual and is a party to the other solely in his representative capacity. See generally, 1B MOORE, FEDERAL PRACTICE § 0.411, at 1421-1448 (2d ed. 1953); see also, *Baum* v. *Continental Illinois National Bank & Trust Company,* 230 F.2d 115 (7th Cir. 1956). This principle is also well stated in *Hartford National Bank & Trust Company* v. *Malcolm-Smith,* 129 Conn. 67, 26 A.2d 234 (1942); see also, RESTATEMENT OF JUDGMENTS §§ 80(a), 85, comment n; 54 AM. JUR. 2d *Trusts* § 632.

The second element necessary to the application of the doctrine is also missing in this case. Clearly, the state court did not have before it nor did it decide the specific allegations of negligence charged by the respondents. The state court did not have before it the key issue of the improper delegation of fiduciary duties, nor did it have to consider the reasonableness of the trustee's expenditures; all of these matters had to be decided by the court in bankruptcy. As the Court of Appeals succinctly stated, "The beneficiaries and

creditors are no more barred by the judgment in the Oklahoma suit than the district court would be barred from surcharging the trustee." (Pet. App. A, A-12.)

The petitioner has demonstrated no basis which would warrant review by this Court on certiorari. The petitioner asserts an interpretation of Section 845 of the Bankruptcy Act is at stake. This is not correct. The only question involved in this whole case is whether Trustee Clark performed his duties as a fiduciary in accord with the required standard of care. In the judgment of the Court of Appeals, under the established legal principles, he did not and should be surcharged for his deficiencies. The amount of the surcharge has been left to the discretion of the lower court on remand.

CONCLUSION

For the foregoing reasons, it is respectfully submitted that this petition for a writ of certiorari should be denied.

Respectfully submitted,

MICHAEL S. YAROSCHUK
TIMOTHY J. PARSONS
918 Sixteenth Street, N.W.
Washington, D. C. 20006
Attorneys for Respondents

Of Counsel:

HAROLD E. KOHN, P. A.,
Attorneys at Law
1776 K Street, N.W.
Washington, D. C. 20006

ANDREW C. WILCOXEN
112 North Fifth Street
Muskogee, Oklahoma 74401

A. CARL ROBINSON
213 North Third Street
Muskogee, Oklahoma 74401

Certificate of Service

On this 10th day of September, 1975, the undersigned certifies that three exact copies of this Brief for Respondents in Opposition have been directed by United States Mail, postage prepaid, to each of the following addressees, to wit:

Henry W. Simon, Esq.
John W. Hughes, Esq.
Simon & Simon
800 Baker Building
110 West Seventh Street
Fort Worth, Texas 76102

J. D. DeBois, Esq.
O. L. Peck, Jr., Esq.
DeBois, Peck & Sherrill
P. O. Box 1427
Duncan, Oklahoma 73533

same being attorneys of record for the petitioners herein.

MICHAEL S. YAROSCHUK

APPENDIX

IN THE FEDERAL DISTRICT COURT FOR THE
EASTERN DISTRICT OF OKLAHOMA

(Judge Rice, presiding)

IN THE MATTER OF ROY M. JOHNSON, *Debtor.*
BK-8330

Order

(Filed February 15, 1961)

Upon Application of the Trustee herein, Gordon D. Clark, it is hereby ORDERED that annual audit shall be filed by the Trustee on or before the first day of September, 1961, reflecting the operations of said Trust from inception to July 31, 1961.

It is FURTHER ORDERED that future annual audits shall be filed by the Trustee on or before the first day of September of each year reflecting the operations of said Trust for the past fiscal year ending July 31st of each year.

It is the FURTHER ORDER of the Court that each creditor shall be mailed a copy of said audit at the time of filing same with the Clerk of this Court.

DATED this 15th day of February, 1961.